Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

22nd September 2017

Market overview

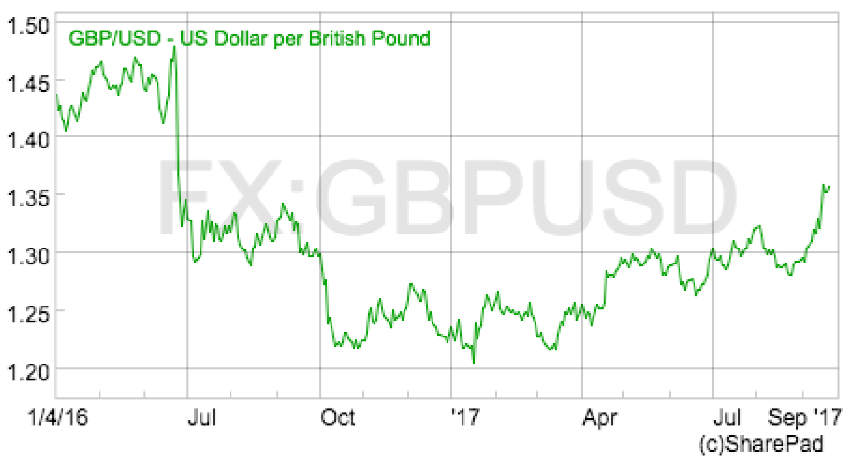
Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7263.9	▼-0.432	▼-0.751	▲6.28	7547.63	6693.26	2/6/17	4/11/16
FTSE 250	19418.3	▼-0.541	▼-1.16	▲8.28	20024.9	17271.2	26/5/17	4/11/16
FTSE SmallCap	5643.52	▼-0.38	▼-0.414	▲13.4	5742.98	4862.64	8/8/17	11/11/16
FTSE AIM 100	5020.17	▼-1.11	▼-1.79	▲29.7	5188.4	3817.03	1/9/17	4/11/16
FTSE All-Share	3985.05	▼-0.448	▼-0.807	▲6.86	4130.15	3641.91	26/5/17	4/11/16
S&P 500	2504.1	▲0.34	▲3.12	▲15.8	2508.24	2085.18	20/9/17	4/11/16
Brent Oil Spot $	$56.2195	▲1.67	▲8.69	▲19.5	$56.965	$44.565	29/12/16	11/11/16
Gold Spot $ per oz	$1294.00	▼-3	▲0.175	▼-2.96	$1349.10	$1128.22	7/9/17	15/12/16
GBP/USD - US Dollar per British Pound	1.35773	▲1.34	▲5.27	▲4.18	1.3591	1.20401	15/9/17	16/1/17
GBP/EUR - Euros per British Pound	1.1361	▲1.09	▲4.03	▼-2.45	1.1972	1.0795	18/4/17	29/8/17

Shares have pulled back over the week. It is interesting to see that the FTSE 100 is only just up for the year in price terms and the same can be said for the FTSE All-Share Index.

The chief reason for this is the rise in the value of the pound which has had another strong week. It has appreciated by over 10% against the dollar so far this year.

I mentioned last week how the rise in the pound had negated the gain in the gold price for UK-based investors. If the strength continues it has big implications for many shares as well. Big overseas earners such as Reckitt Benckiser and Intercontinental Hotels have seen their shares fall by 15% over the last three months.

Shrewder investors will have noticed that many small and mid cap shares have benefitted from the weakness of the pound but for many underlying growth has been actually quite modest. The pound is now a drag on dollar earnings compared with a big boost last year. It would not be surprising if analyst forecasts are behind the curve on this potential effect and that profit forecasts could start coming down for some companies.



Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	IRV	Interserve PLC	▲58.3
2	JMAT	Johnson Matthey PLC	▲20.2
3	JDW	Wetherspoon (J D) PLC	▲17.8
4	DEB	Debenhams PLC	▲12.5
5	NANO	Nanoco Group PLC	▲12.5
6	OXB	Oxford BioMedica PLC	▲11
7	DOM	Domino's Pizza UK & IRL PLC	▲9.48
8	ITV	ITV PLC	▲6.99
9	INDV	Indivior PLC	▲6.97
10	CHG	Chemring Group PLC	▲6.42

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	PDL	Petra Diamonds Ltd	▼-17.7
2	OXIG	Oxford Instruments PLC	▼-14.5
3	CMBN	Cambian Group PLC	▼-11.1
4	LMI	Lonmin PLC	▼-10.9
5	CPI	Capita PLC	▼-9.32
6	MGP	Medica Group PLC	▼-9.05
7	SPI	Spire Healthcare Group PLC	▼-8.8
8	FOXT	Foxtons Group PLC	▼-8.01
9	PFG	Provident Financial PLC	▼-7.84
10	STVG	STV Group PLC	▼-7.23

Share Discussion: Finsbury Foods (AIM:FIF)

Finsbury Foods is a specialist bakery business with eight factories in the UK. It specialises in making nice cakes and breads and sells them to retailers, wholesalers and direct to places such as pubs, hotels and restaurants (referred to as foodservice companies).

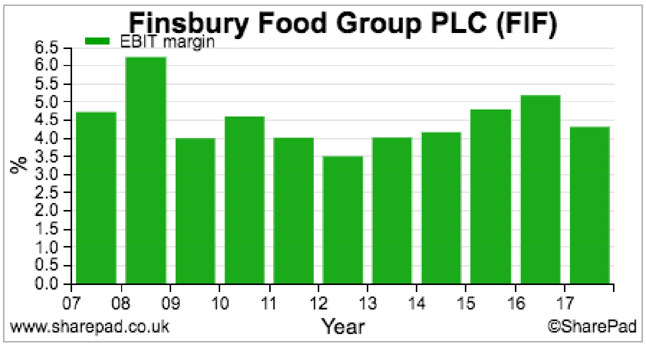
It has its own brand business called Kara which sells products into the foodservice sector. The bulk of the company's revenue comes from making cakes and breads under licence for the following brands:

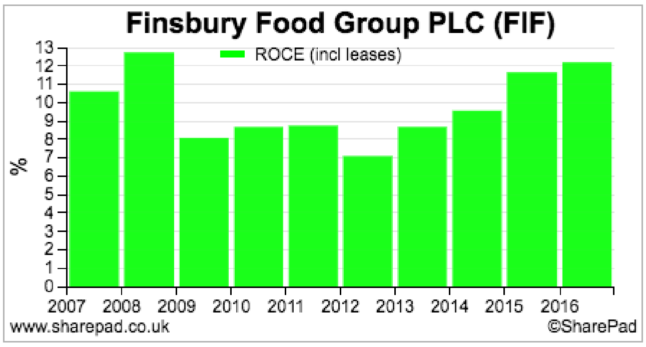
- Disney (cakes)
- Thorntons (cakes)
- Weight Watchers (cakes)
- Mary Berry (cakes)
- Mars (cakes)
- Vogel's (seeded bread)
- Village Bakery (rye bread)
- Cranks (organic bread)

Finsbury also has a 50% stake in Lightbody Stretz Ltd which sells its cakes and breads in countries such as France, Belgium and Holland.

Finsbury has to work hard for its money. It is trying to carve out a niche for itself as a low-cost specialist baker, making and selling differentiated and high quality products. It is dealing with big customers who have a lot of buying power and put a lot of pressure on it to give them better products without paying more for them.

This means that it is hard for Finsbury to make high profit margins.

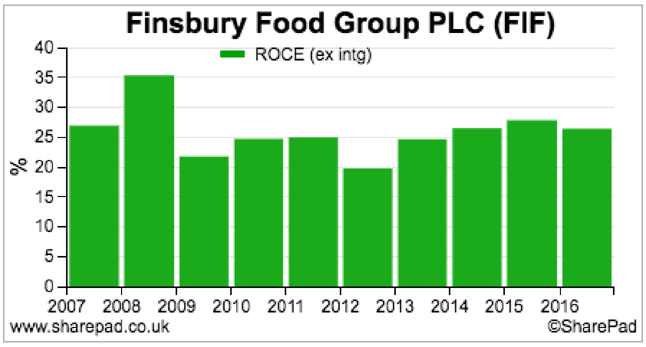


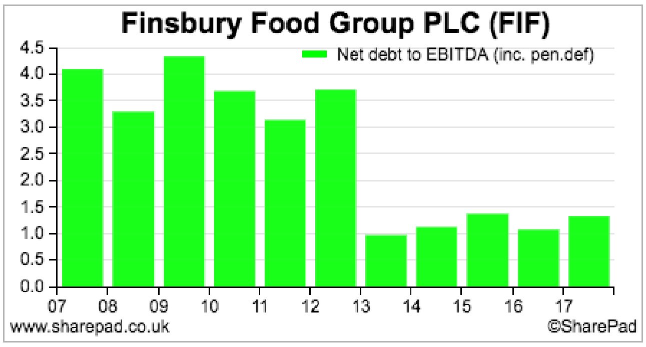


With assets tied up in eight factories, these low margins do not help it to make high returns on money invested (capital employed).

Finsbury's ROCE is not terrible by any means. You can also see that it has been increasing nicely for the last five years which is an encouraging sign. A ROCE of 12% is a sign of a decent but not a top quality business in my view.

One important point to note is that a very large chunk of Finsbury Foods' capital employed comes from the goodwill paid for past acquisitions. There are some other small intangible assets to do with brands, licences and customer relationships. If these are ignored, then the company's return on tangible capital employed looks to be very good.

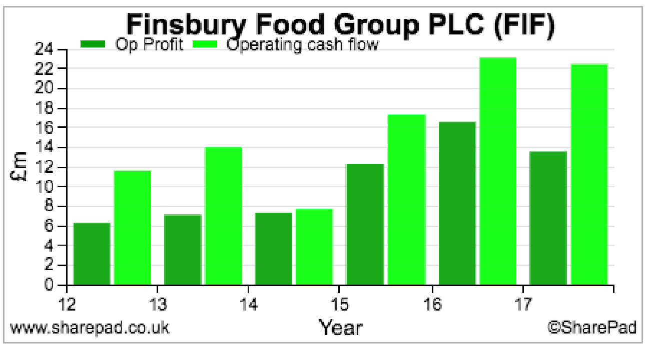


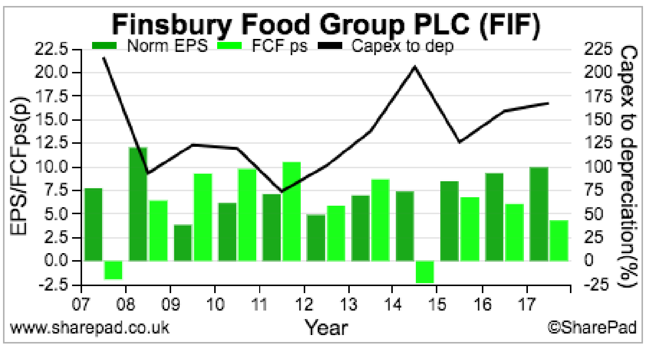


Low profit margin businesses should not be loaded up with lots of debt in my opinion. This is because, low margin businesses can become no margin businesses in times of difficult trading conditions. The good news for investors is that Finsbury does have some debt - and a pension deficit - but nothing that seems too problematic.

Net debt to EBITDA (including the pension fund deficit) is at a comfortable level as is fixed charge cover (how many times operating profits cover the interest and rent bills) at over 4 times.

Cash generation seems reasonable. Operating cash flow is greater than operating profits which is a good sign.



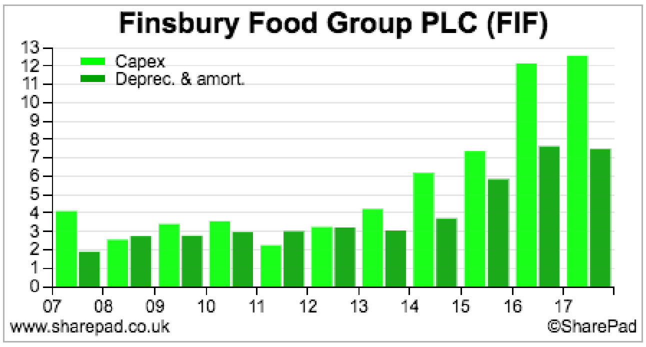


It is not as good at turning its earnings per share into free cash flow per share due to high rates of investment in more efficient machinery.

There's nothing wrong with companies investing. The question you need to ask as an investor is whether the investment is replacing existing assets or new assets to help the company grow. This is a bit of a grey area with Finsbury.

Capex has been higher than depreciation for the last five years - especially so during the last two.

The £12.8m spent in 2017 mostly relates to a new automated cake line, new IT systems and a new artisan bakery. With the exception of the new bakery, I would say that there is a large replacement element here, albeit the kind of improvements that will make the business more efficient. The company did not break out the split of its capex in its results release.



I think Finsbury looks to be a solid, decent business operating in quite tough end markets. As with any business, the investor wants to know if it can grow and whether they can buy the shares at a reasonable price.

Finsbury Food Group PLC (FIF)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	28/6/14	27/6/15	2/7/16	1/7/17	1/7/18	1/7/19
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS						
Turnover	175.7	256.2	319.7	314.3	322.5	327.3
Norm EBITDA	11.0	18.1	24.2	21.0	26.2	27.2
EBIT	7.3	12.3	16.6	13.5	-	-
EBIT margin	4.2	4.8	5.2	4.3	-	-
Norm Pre-tax	7.3	11.7	16.1	17.0	17.3	18.4
EPS(p)	7.4	8.5	9.3	10.0	10.0	10.6
EPS % chg	▲5.7	▲14.9	▲9.9	▲6.8	▲0.5	▲6.0
Dividend per share Adj	1.0	2.5	2.8	3.0	3.2	-
Dividend per share %chg Adj	▲33.3	▲150.0	▲12.0	▲7.1	▲6.7	-
Dividend cover	7.4	3.4	3.3	3.3	3.1	-

There was not much growth to speak of in 2017. The UK business struggled due to pressure on selling prices and increased ingredient and labour costs. These cost pressures are not going to go away anytime soon with the company mentioning rising butter costs for its cakes.

It has renewed its licensing agreement with Thorntons and won some new ones for cakes branded as Mary Berry and from Mars. The overseas business is growing nicely and looks to be capable of growing its profits.

City analysts are not predicting much in the way of profit growth over the next couple of years which seems to be a reasonable assumption. Given that backdrop, it is not really surprising that the shares trade on a modest forecast PE of just over 10 times and for slightly more than an estimate of its earnings power value (EPV).

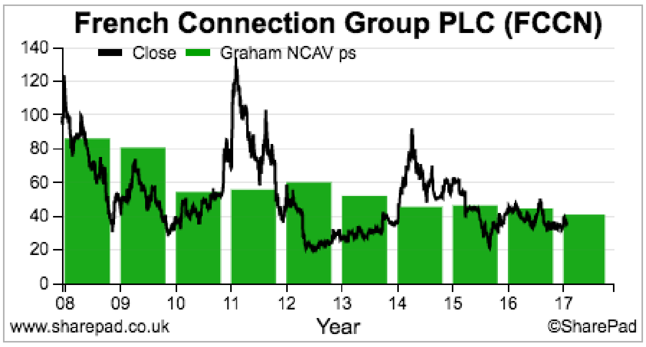
Name	Close	Market Cap. (m)	fc PE	fc Yield	EPV ps (7%)
Finsbury Food Group PLC	101p	£131.7	10.1	3.2	91.4p

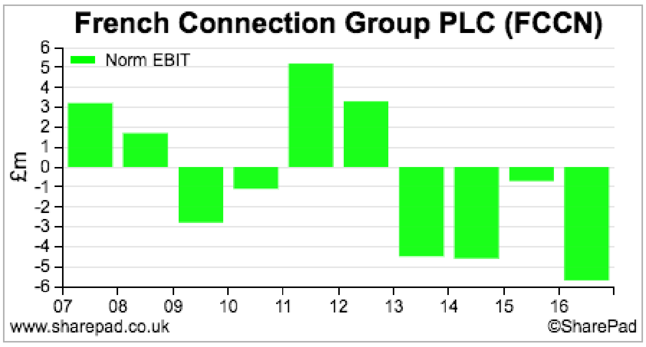
Share Discussion: French Connection (LSE:FCCN)

If you like investing in shares that appear to be exceedingly cheap then there's a good chance that French Connection may have popped up on one of your screens over the years. For quite some time, its share price was less than its net current asset value per share (NCAVps).

NCAV is a company's current asset value (stocks, cash, debtors) less all its liabilities and ignoring any non current assets such as land or property. This measure was used by legendary value investor Benjamin Graham as a very conservative estimate of a company's liquidation value. He reckoned that if he could but a share for less than its NCAV then he was unlikely to lose money and might end up making some.

At a current share price of 43.75p and a NCAVps of 34p, the shares no longer qualify for Graham's bargain screen but that doesn't mean that French Connection is not a very interesting share to look at.





A cursory glance at its recent financial history could lead you to dismiss this business.

It has made a trading loss for the last four years which might go a long way to explaining why the shares have been so lowly valued compared with its net current assets. Those who swiftly move on probably don't realise how that loss is made up. The loss-making high street shops have diverted attention away from a profitable wholesale business.

We can see from the segmental profit split above that Wholesale made £10m of trading profits last year but this and licence income (for products using the French Connection brand such as perfume and furniture) was not enough to offset the losses from the retail business and the quite large group overheads.

1. Segment revenue and results

Income Statement	Six months 31 July 2017 GBPm	Six months 31 July 2016 GBPm	Year ended 31 Jan 2017 GBPm
Revenue			
Retail	38.5	41.6	87.9
Wholesale	29.6	27.6	65.3
Group revenue	68.1	69.2	153.2
Gross profit	31.1	31.8	70.1
Retail	56.6%	56.3%	56.8%
Wholesale	31.4%	30.4%	30.9%
Group gross margin	45.7%	46.0%	45.8%
Underlying operating (loss)/profit			
Retail	(6.7)	(8.2)	(9.8)
Wholesale	3.9	3.0	10.0
Licence income	2.6	2.4	6.3
Common and Group overheads	(5.1)	(4.8)	(9.4)
Share of loss from joint ventures	(0.4)	(0.3)	(0.8)
Underlying Group operating loss*	(5.7)	(7.9)	(3.7)

However, this week's interim results showed that life is getting better across the board for French Connection. The half year trading loss came down from £7.9m to £5.7m as Retail losses were lower and Wholesale profits and licence income were higher.

This is how the profitability of the business looks like on a trailing twelve month (TTM) basis:

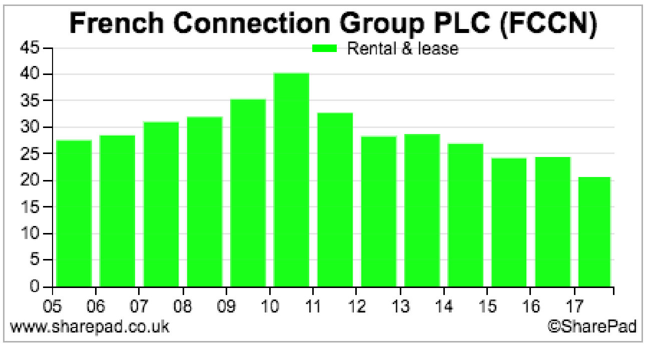
We can see that French Connection is not far away from actually getting to a breakeven position for the group as a whole on a TTM basis. We can also see that this is a seasonal business with all three profit centres making considerably more profit in the second half of the year - presumably due to Christmas.

French Connection (£m)	H2 2017	H1 2018	TTM
Retail	-1.6	-6.7	-8.3
Wholesale	7.0	3.9	10.9
Licence income	3.9	2.6	6.5
Overheads	-4.6	-5.1	-9.7
Share of JVs	-0.5	-0.4	-0.9
Underlying loss	4.2	-5.7	-1.5

The bull case for this business and its shares is that the retail business can eventually stop losing money. To do this it has to shed loss making stores when the leases on them expire. This is what it seems to be doing with seven fewer stores during the first half of the year and average selling space down by over 10%. There has been good control of overheads and a bigger focus on full priced sales and fewer discounts (something that Next is very good at). The second half of the year has started well.

It is still going to take a while to shed all the poorly-performing stores but the rent expense is on a firmly downwards trend as shown in the chart below.

The outlook for the Wholesale business is very upbeat with strong order books for the winter collection and promising reactions to the spring 2018 pipeline. It seems reasonable to expect that profits can keep on growing here.

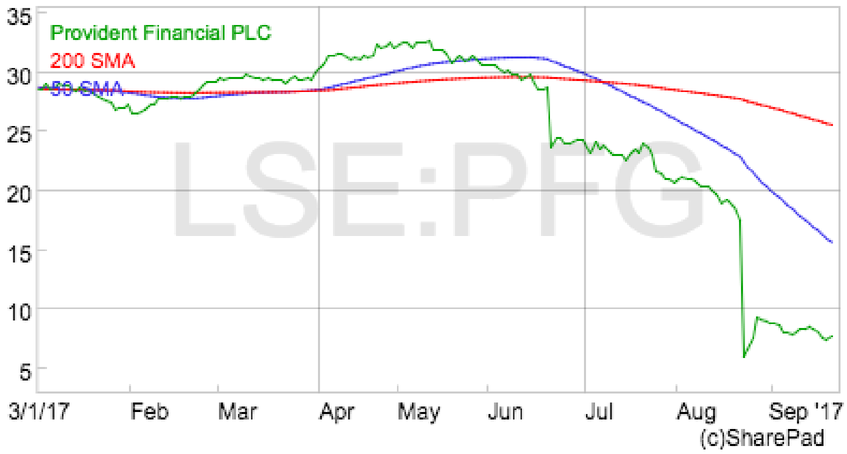


City analysts are still expecting an overall loss for the year to January 2018 with a small profit the year after. With a market capitalisation of £43m and an enterprise value of closer to £30m based on likely year end cash balances (perhaps around £12m as a guess) French Connection doesn't cost too much to buy outright for a trade buyer. Perhaps this is why Sports Direct owns 27% of the business at the moment.

This may not be the highest quality of businesses and its shares have proven to be a value trap in the past, but there seems to be good profit momentum here. Long term value investors might finally stand a chance of making some good money from this share. This is a business that readers might wish to spend some time researching.

Share Discussion: Provident Financial Retail Bonds

Shares in Provident Financial have been hammered this year due to problems with its doorstep lending business. I reviewed the shares back in July (click **here** to read the newsletter) and wasn't too enthusiastic about them but I did note that its financial position was fairly reasonable for a financial company.



The shares may be high risk and shareholders will not get a dividend this year but the reasonable financial position does make the company's retail bonds something worth considering.

Bonds are less risky than shares because bondholders get paid before shareholders. Sometimes they can allow investors to lock in some decent returns for less risk.

Retail bonds are often ignored by equity investors. That's perfectly fair but sometimes they can throw up some interesting opportunities. I made some nice profits buying retail bonds during the panic of 2008/09 and often keep an eye on this market.

As you can see Provident has four retail bonds listed on the stock exchange with one just about to mature. There are three others which mature over the next six years which offer yields to maturity of between 8% and 9%.

Name	Close	Income yield	Gross redem. yield	Maturity	Coupon date	Years to redemption	1 y high	1 y low
Provident Financial PLC 7% NTS ...	£99.375	7.04	20.73	4/10/17	4/10/17	0.04	£105.50	£96.15
Provident Financial PLC 7.00% G...	£95.45	7.33	9.02	14/4/20	16/10/17	2.57	£114.475	£77.00
Provident Financial PLC 6.00% N...	£90.475	6.65	8.93	27/9/21	27/9/17	4.02	£113.225	£71.525
Provident Financial PLC 5.125% ...	£85.45	5.98	8.16	9/10/23	9/10/17	6.05	£111.20	£66.50

The prices of these bonds were hammered on the back of the recent profit warning but you can see from the table above that they have all bounced strongly off their yearly lows.

I am quite late to the party in terms of raising these bonds as an investing idea to consider but all these bonds can still be bought below their par values of £100 which means there is a chance of a capital gain if they are held to maturity.

But just how risky are these bonds?

Well high yields are telling you that they are reasonably risky. However, there are some basic checks you can do when looking at them. If you are seriously thinking about investing in any bond then I suggest that you read the prospectus which would have been published at the time of their listing. This will include a description of the risks involved such as early redemption and the pecking order of payment if the company becomes insolvent.

One really basic check is to look at the company's interest cover - the number of times a company's trading profit covers the annual interest bill. The higher this number the safer the bonds will be.

Provident has shelled out £93m on cash interest payments during the last year and had more than enough operating profit to pay them.

Provident Financial PLC (PFG)

← Prev Next →	2015	2016	2017	2017	2018	2019
Fiscal period ending	31/12/15	31/12/16	30/6/17	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	Q4	TTM	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	1,113.1	1,183.2	1,231.0	1,212.1	1,198.1	1,160.7
Norm EBITDA	388.0	451.8	374.8	676.6	676.3	751.5
EBIT	365.4	426.1	348.6	676.6	676.3	751.5
EBIT margin	32.8	36.0	28.3	55.8	56.4	64.7
Norm Pre-tax	285.4	344.4	287.8	120.5	210.5	250.0
EPS(p)	156.3	180.1	154.1	51.2	100.9	150.5
EPS % chg	▲21.8	▲15.3	▼-14.9	▼-71.6	▲97.1	▲49.2
Dividend per share Adj	120.1	134.6	134.6	134.6	34.9	82.6
Dividend per share %chg Adj	▲22.6	▲12.1	▲8.5	▼0.0	▼-74.1	▲136.7
Dividend cover	1.3	1.3	1.1	0.4	2.9	1.8

Analyst forecasts should always be taken with a big pinch of salt for a business such as Provident which has seen such a rapid deterioration in its fortunes. Things could get worse before they get better.

If forecasts are believable then Provident is expected to make a pre-tax profit for the next three years - in other words after interest on all its debts and bonds have been paid. This suggests that the coupons on the retail bonds are still relatively safe. Food for thought perhaps?