Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

13th October 2017

Market overview

No.	Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
1	FTSE 100	7556.24	▲0.643	▲2.1	▲7.58	7556.24	6693.26	12/10/17	4/11/16
2	FTSE 250	20251.2	▲0.81	▲2.98	▲12.8	20251.2	17271.2	12/10/17	4/11/16
3	FTSE SmallCap	5826.58	▲0.524	▲2.23	▲16	5826.58	4862.64	12/10/17	11/11/16
4	FTSE AIM 100	5258.84	▲1.06	▲2.57	▲32.4	5258.84	3817.03	12/10/17	4/11/16
5	FTSE All-Share	4145.98	▲0.666	▲2.25	▲8.7	4145.98	3641.91	12/10/17	4/11/16
6	S&P 500	2554.02	▲0.0764	▲2.3	▲19.4	2555.24	2085.18	11/10/17	4/11/16
7	Brent Oil Spot $	$56.4495	▼-0.94	▲4.05	▲9.26	$59.135	$44.565	25/9/17	11/11/16
8	Gold Spot $ per oz	$1292.70	▲1.85	▼-2.88	▲3.07	$1349.10	$1128.22	7/9/17	15/12/16
9	GBP/USD - US Dollar per British Pound	1.32437	▲0.997	▼-0.339	▲8.67	1.3591	1.20401	15/9/17	16/1/17
10	GBP/EUR - Euros per British Pound	1.119	▼-0.0447	▲0.802	▲1.1	1.1972	1.0795	18/4/17	29/8/17

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	MLC	Millennium & Copthorne Hotel...	▲29.1
2	DPEU	DP Eurasia NV	▲15.6
3	LMI	Lonmin PLC	▲13.2
4	XPP	XP Power Ltd	▲12.9
5	GDWN	Goodwin PLC	▲9.8
6	JE.	Just Eat PLC	▲8.79
7	DOM	Domino's Pizza Group PLC	▲8.57
8	NMC	NMC Health PLC	▲8.45
9	RWA	Robert Walters PLC	▲8.26
10	MCB	McBride PLC	▲7.95

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	RNO	Renold PLC	▼-13.5
2	PDL	Petra Diamonds Ltd	▼-10.4
3	UPGS	UP Global Sourcing Holdings ...	▼-9.24
4	PETS	Pets at Home Group PLC	▼-9.21
5	MNDI	Mondi PLC	▼-8.69
6	MER	Mears Group PLC	▼-8.24
7	PFG	Provident Financial PLC	▼-8.2
8	LAM	Lamprell PLC	▼-7.51
9	CPR	Carpetright PLC	▼-7.5
10	IRV	Interserve PLC	▼-7.08

Share Discussion: Marston's (LSE:MARS)

Marston's is Britain's biggest brewer of ale. It has a 25% share of the premium cask ale market and a 29% share of the premium bottled ale market. This has been built up over the years primarily by buying up the brands and breweries of other brewers. It now has an enviable portfolio of ale brands such as Pedigree, Thwaites Wainwright, Hobgoblin, Brakspear and Bombardier. It also brews Young's under licence.

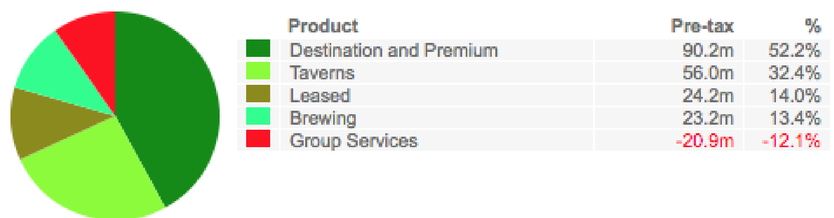
Despite its brewing heritage, Marston's makes most of its money from owning and operating over 1500 pubs. These range from premium high street bars such as Pitcher & Piano, to family food-

led pubs and local boozers. The company also rents out pubs to landlords who want to run their own pub. In recent years, Marston's has also been opening lots of lodges to tap into the growing budget hotel market.

The UK pub market is fiercely competitive with only a few big pub companies seemingly able to thrive in the current marketplace. Marston's suffers in comparison to the likes of Young's and Fuller Smith & Turner by not having a significant presence in the south of England and London. Instead most of its pubs are in the Midlands and the North where it is harder to make money.

Marston's PLC (MARS)

ACTIVITY BREAKDOWN Last updated 1/10/16



Product	Pre-tax	%
Destination and Premium	90.2m	52.2%
Taverns	56.0m	32.4%
Leased	24.2m	14.0%
Brewing	23.2m	13.4%
Group Services	-20.9m	-12.1%

Turnover | Pre tax profit | Total assets

Marston's has been having a hard time which has driven its share price to a five year low. Its problem is simple. It cannot grow its sales fast enough to offset the rising costs of wages, energy and business rates. It is managing to cut some costs to offset these pressures and is able to grow its profits slightly by opening up new pubs and lodges.

This week's trading update revealed that its premium and destination pubs had grown their LFL sales by just 0.9%. This compares with rival JD Wetherspoon which is currently growing at 6% on a similar basis. The Taverns (local pubs) fared a little better with LFL growth of 1.6% whilst the leased pubs saw profit growth of 1%.

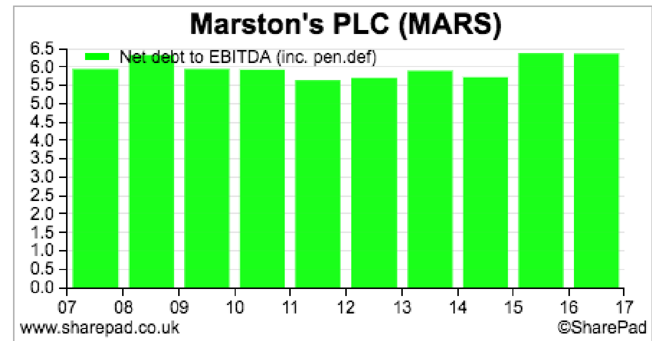
The Brewing business is doing well with 6% volume growth from its own brand portfolio. It is also making good progress with integrating the Charles Wells business into the company.

Yet it seems that growth is not going to come easy to this business any time soon but at least there is some thanks to the new pub and lodge openings.

Marston's PLC (MARS)

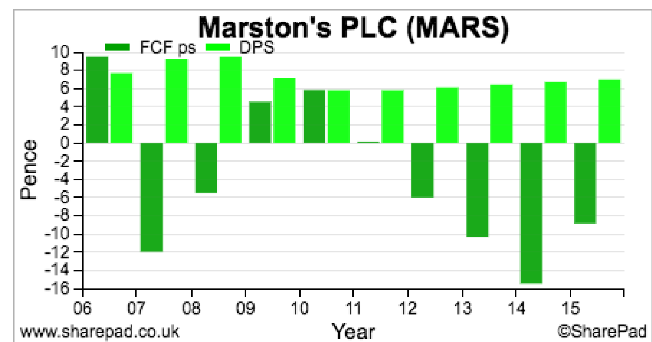
← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	4/10/14	3/10/15	1/10/16	1/10/17	1/10/18	1/10/19
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	815.3	878.6	937.3	962.7	1,064.0	1,102.3
Norm EBITDA	209.3	195.2	204.7	220.1	234.1	243.0
EBIT	173.0	157.3	164.7	179.7	192.1	199.8
EBIT margin	21.2	17.9	17.6	18.7	18.1	18.1
Norm Pre-tax	91.9	83.4	90.0	100.8	110.2	120.1
EPS(p)	17.3	13.0	13.8	13.7	14.3	15.3
EPS % chg	▲36.2	▼-24.9	▲5.8	▼-0.5	▲4.4	▲7.0
Dividend per share Adj	6.7	7.0	7.3	7.6	8.0	8.3
Dividend per share %chg Adj	▲4.7	▲4.5	▲4.3	▲4.1	▲5.3	▲3.8
Dividend cover	2.6	1.9	1.9	1.8	1.8	1.8

Besides growth, there is also the issue of Marston's big debt pile. Its balance sheet looks more like a water company's - which can comfortably sustain large amounts of debt. It has come about from raising large amounts of borrowed money against the value of its pub assets.

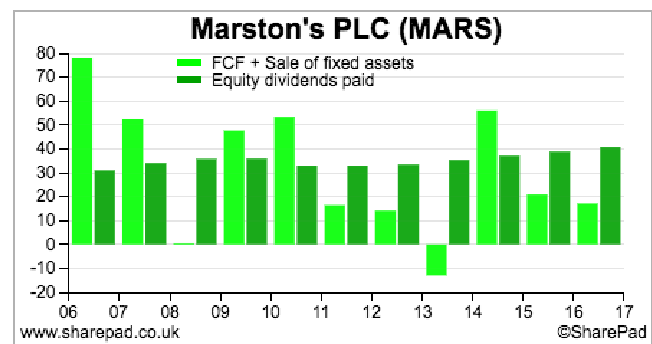


These debts are a source of considerable risk to shareholders in the event of any downturn in trading. The company is currently paying out just over £70m in interest each year from just over £190m of trading cash flow. Shareholders are currently pocketing around £40m in dividends.

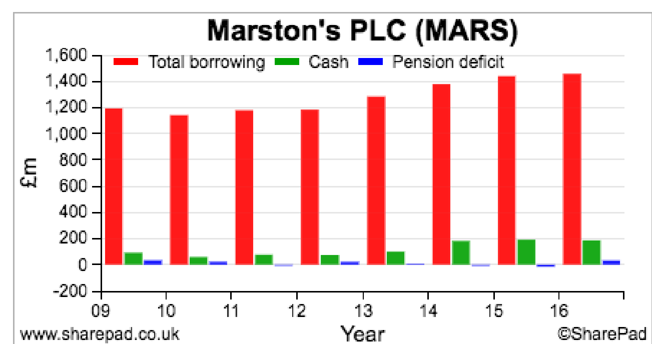
Yet with pubs requiring lots of money to keep them looking nice for customers and new pubs and lodges opening up, Marston's free cash flow has been negative for the last few years.



Given this backdrop, it is right to question the sustainability of the current dividend payout. The dividend looks well covered on the basis of profits with dividend cover of 1.8 times but the cash flow is telling a different story. Sure there is cash being spent on new pubs and extensions and there is also the fact that Marston's - like Greene King and other pub owners - can raise significant amounts of cash by selling a number of its pubs each year. So what's really going on here?



Selling pubs is part and parcel of the business and not a sign of distress. Pub companies regularly sell underperforming pubs which are referred to as the tail of their estate. Yet as you can see from the chart above, even when disposals proceeds are added to free cash flow there still hasn't been enough spare cash to cover the cost of the dividend. Extra borrowing may have made up for the difference - or has it?



You can look at this situation two ways. Either the company is borrowing to grow or it is borrowing to pay its dividend. Marston's helpfully says in its investor presentations that its stay-in-business or maintenance capex has been around £45m for the last couple of years. This compares with a total capex bill of around £150m and depreciation of around £40m.

If we adjust free cash flow to just include maintenance capex then it would have been an inflow of around £68m compared with an outflow of £30m in 2016. This would have been enough to pay the dividend comfortably. With disposals of £47.6m it is in a more comfortable position still. The company then borrows to fund some of its extra investment as shown in the table below.

I wish more companies would tell investors what their stay-in-business capex is because it would allow us to get a better understanding of how cash moves around a business and how sustainable dividends payments are. You can have a go at estimating it yourself but it is not easy and requires you to have a good understanding of the business you are looking at.

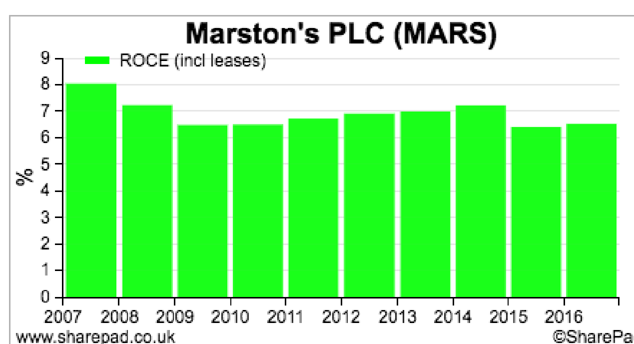
Marston's (£m)	2016
Operating cash flow	192.8
Tax paid	-9.8
Net cash flow from operating activities	**183**
Net interest paid	-70.2
Maintenance capex	-45
Cash available for dividends	**67.8**
Dividends paid	-40.8
Cash available for investment	**27**
Disposal proceeds	47.6
Growth capex	-98.7
Extra borrowing needed	**-24.1**

I think it's fair to assume that Marston's 1500+ pubs will give it a source of cash from disposals on an ongoing basis as poorly-performing ones are sold to make way for new ones. But is Marston's cash spent on new assets paying off?

Barely would be my answer.

ROCE is barely above 6% which is not anything to shout about and might be considered to be a poor return on investment. Interestingly, the company makes the following comment in this week's trading statement:

> *"We remain confident that investment in new pubs and bars creates shareholder value, and is an important component of our strategy to achieve organic growth."*



To me, the fact that it has made this comment suggests that it may have questioned whether the huge amounts of money it is spending is worthwhile. If it has then it was right to do so in my view.

I think it is fair to ask whether spending millions to earn a ROCE of just over 6% is a better use of cash than buying back its own shares - which currently offer a dividend yield of 7% - or paying down debt. If the share price is anything to go by it seems clear that the market is not overly enthused by Marston's investments and the profits coming from its underlying assets.

Might it be better for Marston's to stop opening new pubs and just maintain its existing ones instead? If it did this and was able to maintain its underlying free cash flow at £68m then it could maintain a dividend per share of 7.6p and pay off a net amount of debt of just under £20m for the next five years.

Marston's (£m)	2017	2018	2019	2020	2021
FCF (maintenance)	68	68	68	68	68
Dividends at 7.6p per share	**-48.6**	**-48.6**	**-48.6**	**-48.6**	**-48.6**
Cash for debt repayment	19.4	19.4	19.4	19.4	19.4
Securitisation debt repaid	-28.4	-30	-31.7	-33.4	-35.4
New borrowings	**-9**	**-10.6**	**-12.3**	**-14**	**-16**
Net reduction in debt	**19.4**	**19.4**	**19.4**	**19.4**	**19.4**
Shares (m)	639.4	639.4	639.4	639.4	639.4
Debt reduction per share (p)	3.0	3.0	3.0	3.0	3.0

A reduction in debt would reduce risk for shareholders and equate to 3p per share per year of additional equity value or 10.6p in total including the dividend. This would add up to 53p per share

(undiscounted) over 5 years or around half the current share price.

This possibility, the company's low ROCE and Marston's current low valuation of 7.9 times 2017F EPS suggests that this might be a better way to unlock value for shareholders than buying and building pubs.

Share Discussion: YouGov (LSE:YOU)

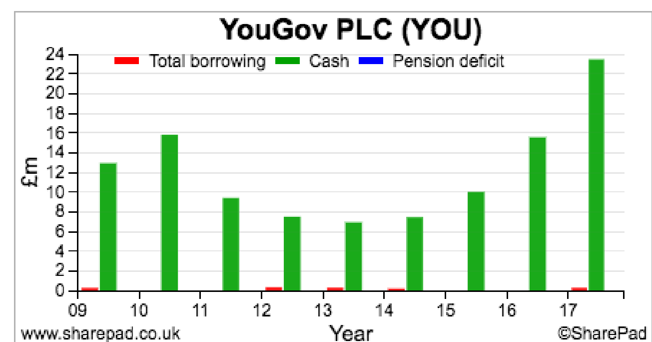
Most people will have heard of YouGov due to its political opinion polls which get a lot of attention at the time of general elections. In reality, the company does a lot more than this.

It is a market research business with two main profit centres - Data Services and Custom Research. The company has ambitions to be a global leader in the data and analytics markets. In order to try and achieve this it is shifting its focus away from traditional market research (surveys and profiles) towards data products and services.

By doing this it hopes that its revenue growth will become increasingly profitable. This is because once a data product is mature it can be sold to multiple customers without any increases in costs. This is not true for market research which tends to be specialised work for one customer.

This strategy seems to be paying off based on the company's annual results which were released this week. Data services saw constant currency sales growth of 24% whilst the custom research saw flat sales. Overall sales were up by 21% with adjusted operating profit - I'll have more to say on this shortly - up by 33%.

The company's flagship YouGov Cube database is proving to be a hit with consumer goods, media and advertising companies as it allows extensive and insightful analysis of customer behaviour and attitudes. YouGov is also bullish about leveraging the analysis which enabled it to accurately predict the 2017 UK General Election result into other markets.



YouGov's finances are in excellent shape with a rising net cash balance over the years. The dividend has been hiked by 43%.

So there is undoubtedly something good going on with demand for the company's products and the current year has started well, but I have to say I don't like the way YouGov accounts for its profits.

I am not the first commentator to raise the issue that ignoring intangible asset amortisation in a business like this is a touch aggressive. But I am inclined to agree with them.

YouGov has intangible assets such as its consumer panel, software, customer contracts, patents and trademarks. The cost of these assets is spread over their useful lives just the same as depreciation does with the cost of tangible fixed assets.

YouGov ignores the amortisation of these intangible assets when stating its adjusted profits as shown below.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 July 2017

	Note	2017 GBP'000	2016 GBP'000
Revenue	1	107,048	88,202
Cost of sales		(21,339)	(19,476)
Gross profit		85,709	68,726
Operating expenses		(78,152)	(64,395)
Operating profit	1	7,557	4,331
Amortisation of intangibles		6,483	5,478
Exceptional items	2	488	1,108
Adjusted operating profit	1	14,528	10,917

The problem with this approach is that amortisation in this case looks as if it is a genuine cash cost.

If you look at the cash flow statement you can see that the cash spent on intangible assets is almost the same as the amortisation expense for the last two years.

	Note	2017 GBP'000	2016 GBP'000
Cash flows from operating activities			
Profit before taxation		7,914	5,526
Adjustments for:			
Finance income		(480)	(2,144)
Finance costs		226	945
Share of post-tax loss of associates		(103)	4
Amortisation of intangibles	7	6,508	5,567
Depreciation	8	1,174	819
Loss on disposal of property, plant and equipment and other intangible assets		7	–
Profit on the disposal of subsidiary undertakings		(94)	–
Share-based payments		1,488	1,111
Other non-cash items		–	(36)
Increase in trade and other receivables		(1,531)	(1,925)
Increase in trade and other payables		2,779	3,229
Increase in provisions		1,026	1,043
Cash generated from operations		18,914	14,139
Interest paid		(2)	(1)
Income taxes paid		(2,487)	(2,365)
Net cash generated from operating activities		16,425	11,773
Cash flow from investing activities			
Acquisition of interest in associates		–	(140)
Proceeds from the sales of subsidiary undertakings net of cash disposed of		150	–
Purchase of property, plant and equipment	8	(843)	(1,003)
Purchase of intangible assets	7	(6,968)	(5,080)

This leaves me to conclude that the company's statutory or reported profits are a better measure than the underlying ones.

When it comes to valuing shares it makes a lot of sense to base it on cash profits or free cash flow rather than underlying profits. At 310p, the shares trade on a forecast PE of 25.4 times. This comes down to 23.6 times once 22p per share of cash is stripped out.

FCF per share was 7.8p in 2017 which gives a cash-adjusted P/FCF multiple of 36.9 times. That's pretty punchy in anyone's book.

Yet the stellar share price performance over the last year or so seems to suggest that investors are not bothered by the amortisation issue and are prepared to pay a high multiple of free cash flow for a fast-growing business. A lot of good news looks priced in with these shares but these kind of shares can keep going up for a while as long as news flow remains positive and forecasts keep going up. Value investors will avoid them.

Share Discussion: Domino's Pizza (LSE:DOM)

Regular readers will know that Domino's Pizza is a business which I like but have had some concerns about. The franchising business has high profit margins, a high ROCE and great free cash flow. The concern I had was about Domino's ability to keep on growing.

Up until this year, Domino's has been a phenomenally successful retail roll out story. An aggressive store opening programme had been turbocharged by very good rates of like-for-like (LFL) sales growth which fed through to rapid profits growth.

My concerns have centred on Domino's strategy of splitting territories - opening new stores close to an existing ones - and the risk of sales cannibalisation. This is what looked to be happening when a slowdown in LFL sales to virtually zero was seen at the interim results in June.

The other worry was that Domino's pricing was out of whack with competitors such as Pizza Hut which could lead it to losing customers.

This week's Q3 trading statement eased some of those concerns for now. LFL sales in the UK were up by 6% - after a cannibalisation effect of 2.1% - and were backed up with strong performances from the company's overseas business.

Domino's has cut its prices and improved its competitive positioning in the UK and has also benefitted from the maturation process of recently opened stores.

The company felt confident enough to say that profits for 2017 would be "at least" in line with expectations.

Domino's shares had been heavily shorted in the run up to this news and the sharp rise in the share price following the announcement was mainly due to a short squeeze as hedge funds bought back the shares they had borrowed and sold previously.

Summary | Company | Income | Balance | Cash | Ratios | Dividends | Brokers | Custom | Sharing

Domino's Pizza Group PLC (DOM)

← Prev Next →	2015	2016	2017	2017	2018	2019
Fiscal period ending	27/12/15	25/12/16	25/6/17	1/12/17	1/12/18	1/12/19
£ millions unless stated	Q4	Q4	TTM	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	316.8	360.6	395.4	439.4	479.3	506.8
Norm EBITDA	80.2	90.3	99.6	99.0	113.3	115.3
EBIT	73.6	82.9	90.7	89.9	98.7	107.3
EBIT margin	23.2	23.0	22.9	20.5	20.6	21.2
Norm Pre-tax	73.6	82.4	83.0	89.9	98.6	107.3
EPS(p)	11.9	13.0	0.2	14.5	16.0	17.6
EPS % chg	▲20.0	▲10.0	▼-99.2	▲11.3	▲10.3	▲10.0
Dividend per share Adj	6.9	8.0	8.2	8.6	9.3	10.2
Dividend per share %chg Adj	▲18.6	▲15.7	▲11.2	▲7.5	▲8.1	▲9.7
Dividend cover	1.7	1.6	0.03	1.7	1.7	1.7

Does this mean that Domino's is out of the woods?

Not yet. Whilst profits are expected to be at least in line with expectations forecasts have come down over the last 3 months. In July consensus Pretax/EPS was £104.2m/16.6p and it is now £98.6m/16p which puts the shares on a forecast PE of 21 times at a share price of 337p.

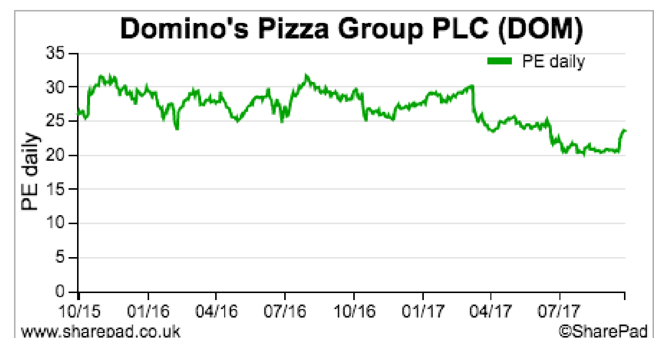
Domino's quality deserves a high valuation in my opinion, but I think it is too early to sweep concerns about sales cannibalisation under the carpet. Many of the split territories are still getting up to speed and I don't think we have seen the full impact on LFL sales yet.

It's easy to forget with a company like Domino's that the health of the business depends ultimately on the health of its franchisees and their ability to keep buying more pizzas ingredients from it and paying the franchise royalty payments which are a proportion of store sales.

They are the ones that have to contend with issues such as local competition, cannibalisation, consumer confidence and rising wage costs. They are also the source of growth as many franchisees take on more than one store. They are unlikely to welcome competition in their territories from a rival Domino's franchise.

It would be rather mean-spirited not to acknowledge that Domino's has done a good job during the last three months. Yet shareholders have made little money over the last couple of years as the de-rating of the shares has offset profit growth.

Domino's is still confident that there is plenty of growth to go for in the UK as well as a growing contribution from overseas. All being well this should keep profits growing. But can these shares rerate upwards to a higher multiple of earnings again? Doing this from a starting PE of 21 times is challenging and probably needs to see meaty forecast upgrades. This is not impossible. In the absence of this, the shares may track earnings growth going forward.



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