Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

20th October 2017

Market overview

No.	Name	Price	%chg 1w	%chg 1m	%chg 1y	1 y high	1 y low	Date 1 y high	Date 1 y low
1	FTSE 100	7541.77	▲0.084	▲3.71	▲7.33	7556.24	6693.26	12/10/17	4/11/16
2	FTSE 250	20163.3	▼-0.475	▲3.19	▲12.4	20259.8	17271.2	18/10/17	4/11/16
3	FTSE SmallCap	5847.12	▲0.401	▲3.44	▲16.9	5850.07	4862.64	16/10/17	11/11/16
4	FTSE AIM 100	5196.45	▼-1.29	▲3.36	▲30.7	5265.84	3817.03	17/10/17	4/11/16
5	FTSE All-Share	4137.22	▲0.00387	▲3.61	▲8.47	4145.98	3641.91	12/10/17	4/11/16
6	S&P 500	2562.1	▲0.35	▲2.15	▲19.6	2562.1	2085.18	19/10/17	4/11/16
7	Brent Oil Spot $	$56.865	▼-0.56	▲1.17	▲10.6	$59.135	$44.565	25/9/17	11/11/16
8	Gold Spot $ per oz	$1280.77	▼-1.78	▼-1.41	▲1.24	$1349.10	$1128.22	7/9/17	15/12/16
9	GBP/USD - US Dollar per British Pound	1.31677	▼-0.893	▼-2.39	▲7.44	1.3591	1.20401	15/9/17	16/1/17
10	GBP/EUR - Euros per British Pound	1.1157	▼-0.73	▼-1.79	▼-0.508	1.1972	1.0795	18/4/17	29/8/17

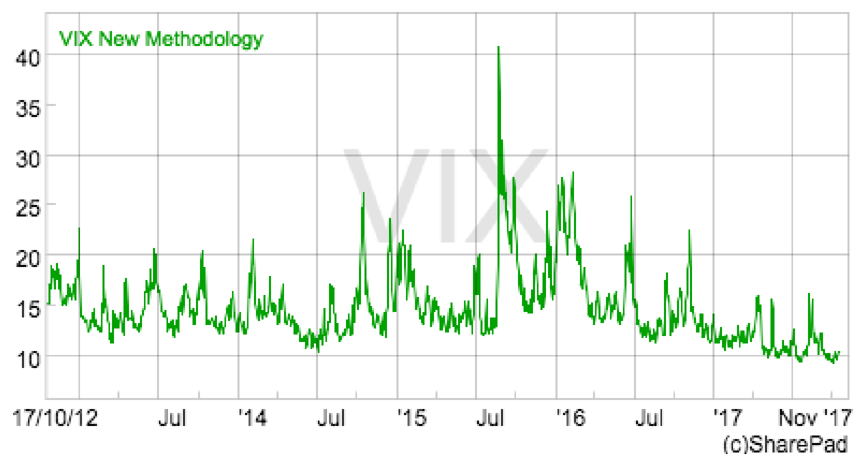
It has been 30 years since the devastating hurricane in the south of England and the stock market crash triggered by the now infamous Black Monday. The windy weather seen earlier this week and the record highs that continue to be seen on world stock markets has raised questions as to whether another crash is imminent.

I've no idea but am fairly certain that we will see a significant stock market correction some time in the future as it is part and parcel of investing in shares. I think the valuations of high-quality growing businesses are very high and leave no scope for disappointment.

Without upgrades to profit forecasts many of these shares look dangerously exposed to me. We have seen pullbacks in the share prices of high flyers such as Bioventix (discussed below) and boohoo.com in recent weeks as evidence of this. As I wrote recently, valuations do matter eventually.

Bulls suggest that we have no euphoria about stocks that traditionally signals the top of the market. This may be true, but bears are short in number. The VIX index or fear gauge of the S&P index is currently at record lows which suggests that there is a lot of complacency out there.

That said, there are still some pockets of decent value out there and I have been buying some new positions in my Isa portfolio this week. My watchlist remains very long. As always, my view is to focus on companies and stocks and not markets. The right company bought at the right price will usually help a long-term investor grow the size of their savings pot.



Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	FOXT	Foxtons Group PLC	▲17.9
2	GAW	Games Workshop Group PLC	▲14.9
3	SPI	Spire Healthcare Group PLC	▲13.2
4	SCT	Softcat PLC	▲11.7
5	BOOT	Boot (Henry) PLC	▲11
6	GMS	Gulf Marine Services PLC	▲9.24
7	PSON	Pearson PLC	▲8.95
8	LUCE	Luceco PLC	▲8.55
9	PDL	Petra Diamonds Ltd	▲7.52
10	MOTR	Motorpoint Group PLC	▲7.27

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	IRV	Interserve PLC	▼-34
2	IWG	IWG PLC	▼-32.7
3	CTEC	ConvaTec Group PLC	▼-23.4
4	MERL	Merlin Entertainments PLC	▼-17.1
5	LWB	Low & Bonar PLC	▼-12.2
6	BWNG	Brown (N) Group PLC	▼-10.9
7	HSW	Hostelworld Group PLC	▼-9.03
8	LAM	Lamprell PLC	▼-7.89
9	TET	Treatt PLC	▼-7.31
10	MTO	Mitie Group PLC	▼-7.18

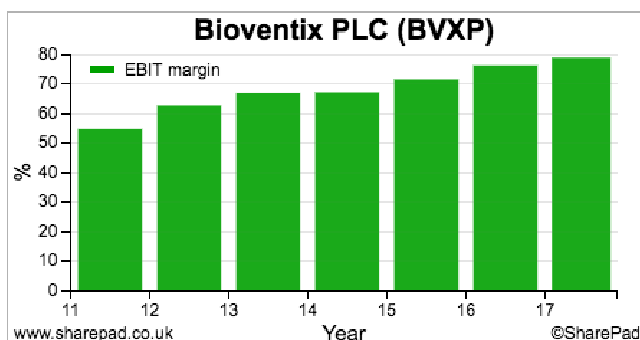
Share Discussion: Bioventix (LSE:BVXP)

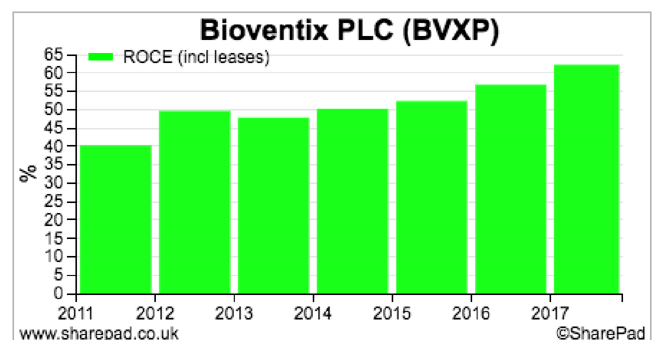
The core of my investing approach in shares is to own the shares of high-quality, resilient businesses that are capable of growing (the last bit is all important). Bought at the right price, owned for long enough and with a bit of good fortune you can hopefully make some decent money from them.

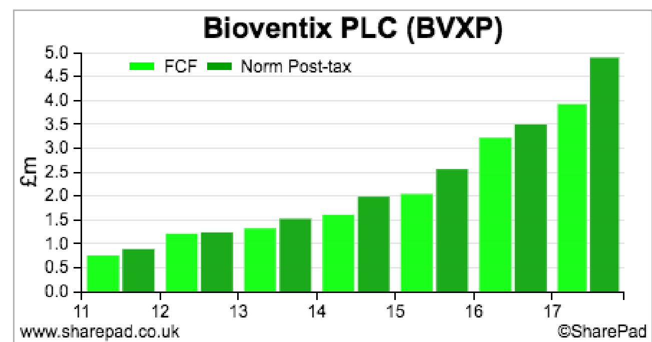
If you were to ask me to name an example of a very high quality business then I would struggle to find a better one than AIM-listed Bioventix.

Bioventix makes antibodies from sheep and uses them to develop products used in medical diagnostic testing. These are sold across the world to big healthcare diagnostic companies and are used in testing for medical conditions such as heart disease, cancer, fertility, thyroid function, vitamin deficiencies and drug abuse.

Every time one of Bioventix's antibodies is used in a test it receives a small royalty. With millions of tests performed every year these small royalties can grow into increasing amounts of revenue. These revenues, spread over the largely fixed costs of 13 scientists and a laboratory in Farnham, Surrey has led to the development of an immensely profitable business and high returns on capital employed (ROCE).







When these two hallmarks of quality have been combined with rapid growth in sales, profits and free cash flow then you can understand why the shares have performed so well.

Further evidence was provided this week when the company released a stunning set of full year results for the year to June 2017. Sales were up by 31% and profit before tax by 37% as growth accelerated in the second half of the year. The final dividend was increased by 19.2% and a special dividend of 40p per share was announced as well. The company said that it only needs £5m of cash on hand for day-to-day operational issues and can let shareholders have any excess.

Usually when a company such as this is so profitable over time it will begin to attract competitors who want a slice of the pie. Although Bioventix has no patents to protect its products it does have reasonable forms of protection to help it maintain its high levels of profitability.

It takes about five years to develop an antibody which is ready to sell commercially and this requires a lot of patience. There is also the tendency for diagnostic companies to stick with what they know. They don't tend to change from something that works.

That said, competition does exist. In the company's press release it did say that there have been developments in rabbit and synthetic antibodies which represented lost opportunities for its own sheep antibodies.

The problem that Bioventix faces in the short term is how it can keep growing its revenues and profits. The company's share price has rocketed during the last eighteen months as it has proven to be good at beating analysts' profit forecasts and getting them to increase them.

Bioventix PLC (BVXP)

← Prev Next →	2014	2015	2016	2017	2018	2019
Fiscal period ending	30/6/14	30/6/15	30/6/16	30/6/17	1/6/18	1/6/19
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS						
Turnover	3.5	4.3	5.5	7.2	6.9	7.8
Norm EBITDA	2.4	3.1	4.2	5.8	5.5	6.2
EBIT	2.4	3.1	4.2	5.7	5.4	6.2
EBIT margin	67.1	71.5	76.2	78.9	78.3	79.5
Norm Pre-tax	2.4	3.1	4.2	5.7	5.4	6.2
EPS(p)	38.7	49.8	68.0	94.2	85.9	98.5
EPS % chg	▲27.9	▲28.5	▲36.5	▲38.7	▼-8.8	▲14.7
Dividend per share Adj	14.4	32.6	42.5	51.0	61.0	73.0
Dividend per share %chg Adj	-	▲126.4	▲30.4	▲20.0	▲19.6	▲19.7
Dividend cover	2.7	1.5	1.6	1.8	1.4	1.3

The lack of profit upgrades for 2018 has seen the share price fall in the days following the results announcement and may be a sign that the momentum from this share has gone - at least for now.

The company faces a couple of major revenue challenges. Firstly it is going to lose around £1m of revenue from its NT proBNP heart failure diagnostic antibody due to the ending of a technology licence. The company has also highlighted that sales from its vitamin D antibody (38% of total sales in 2017) will plateau soon after a little bit more growth in 2018. Then there is the risk of a strengthening pound against the US dollar which would reduce the value of its revenues (which are all in US dollars) when translated back into pounds.

The big hope for significant growth comes from its Troponin antibody which will be used by Siemens in its diagnostic machines. This antibody can allow doctors to quickly tell if someone has had a heart attack or not and can rapidly speed up the treatment process for patients or let them go home without taking up hospital beds.

The problem for Bioventix is that it does not know when the tests are going to start being used which leaves it in the dark when guiding investors as to when it will start making money from it. It's not a case of if it will but when. 2019 looks like a reasonable guess for when the first reasonable revenues will start rolling in.

Elsewhere, there are some ongoing research products which offer the potential of some modest growth whilst there is potential for some revenues to come from the developing Chinese market. The company is also involved in projects with partners in Norway to develop antibodies for diagnosing heart problems and dementia.

All things said, Bioventix is in rude health with good prospects for long-term growth but perhaps not at the levels we have seen over the last few years.

Bioventix has been a classic momentum share driven by a series of forecast upgrades. Investors ignored the valuation of the shares when these were happening and bought into the positive newsflow. Now momentum has disappeared and growth looks unlikely in 2018 there does not seem to be short-term upwards pressure on the share price.

At 2575p at the time of writing, the shares trade on a forward PE of 30 times based on 2018F EPS. This falls to 28.6 times once 120p per share of cash is adjusted for. This is not a cheap valuation despite Bioventix being a truly outstanding business.

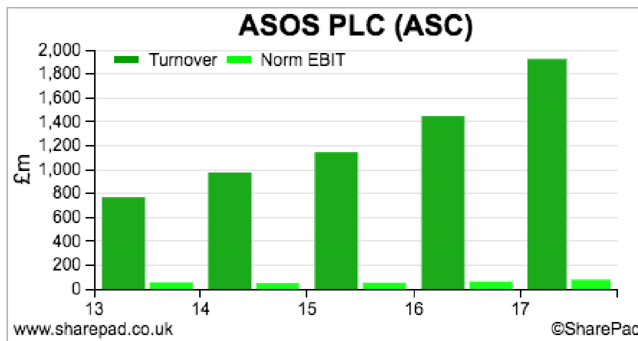
Profit upgrades may come over the next few months if some clarity on Troponin comes through. Without them, it would not surprise me if the shares continued to drift lower - as the share price has risen a lot faster than profits - which may provide a more attractive entry point for long-term investors.

Share Discussion: ASOS (LSE:ASC)

ASOS is aiming to be the world leader in selling fashionable clothing to twenty-somethings. The growth of its sales in recent years suggests that it is having a good go at achieving this. 2017 saw another good set of results with sales up by 27% at constant exchange rates driven by very strong growth overseas which fed through to pre-tax profit growth of 26%.

The company is not opening up lots of shops across the globe but is instead selling over the internet with eight different language websites backed up by large, strategically-placed warehouses to fulfill customer orders. It sells a mixture of own label (41% of sales) and branded clothes at keen

prices to woo fashion-conscious young adults. Its ranges are refreshed regularly to keep customers interested and help the sales to keep growing.



Sales growth is all well and good but it is profits that shareholders are interested in. Profits are growing nicely but operating margins are painfully thin at around 4%. This is despite published gross margins of around 50% which tells us that costs are taking a big chunk out of trading profits. Margins have also been edging down for the last four years.

Asos' level of financial disclosure is very good and gives an outside investor the ability to see how its margins have developed. I've taken its separately disclosed costs and shown these as a percentage of sales so that you can see which bits helped profit margins to increase and which bits acted as a drag on them.

What we can see is that distribution is the biggest single operating cost and took a bite out of margins by increasing by 0.6% of sales. Warehousing increased by 0.85% of sales. This was offset by lower staff and marketing costs as a percentage of sales.

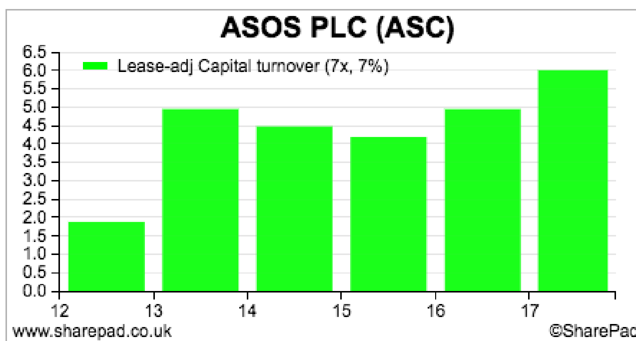
Despite cutting selling prices to gain sales in overseas markets, gross margins held up quite well as Asos sold more products at full prices.

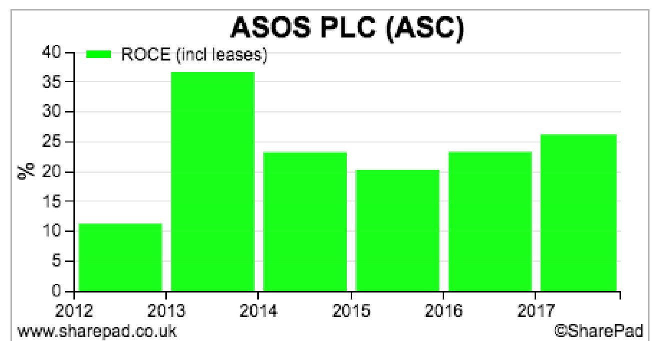
Asos £m	2017		2016	
Sales	1923.6		1444.9	
Costs:		**% sales**		**% sales**
Cost of sales	965.3	50.18%	722.7	50.02%
Distribution	299.2	15.55%	216	14.95%
Staff	162.8	8.46%	132.6	9.18%
Warehousing	168.5	8.76%	114.3	7.91%
Marketing	86.8	4.51%	76.6	5.30%
Production	6.8	0.35%	6.3	0.44%
Technology	35.1	1.82%	24.5	1.70%
Other	77.2	4.01%	57.3	3.97%
Depreciation & Am	42.3	2.20%	31.6	2.19%
Total costs	1844	95.86%	1381.9	95.64%
Operating profit	**79.6**	**4.14%**	**63**	**4.36%**

Going forward Asos is guiding expectations towards profit margins of around 4%. This suggests that it does not expect to show much - if any - operational gearing effects (where profits rise faster than sales) from sales growth of 25%-30% as it seems any leveraging of the sales on fixed or partially-fixed costs will be used to reinvest in price in order to fuel continued sales growth.

Low profit margins can often be a cause for concern for investors as it means that there is not much of a buffer to prevent profits turning into losses if trading deteriorates. On the other hand, a low profit margin strategy can work out well if it means you sell more stuff and take market share.

If we look at Asos' capital turnover (the amount of sales per £1 of capital invested) then the trend is on the up which is a positive development.



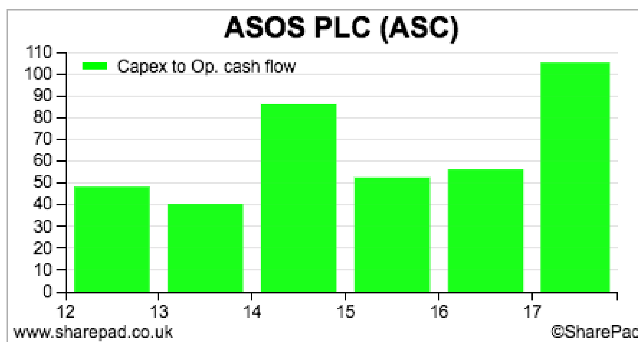


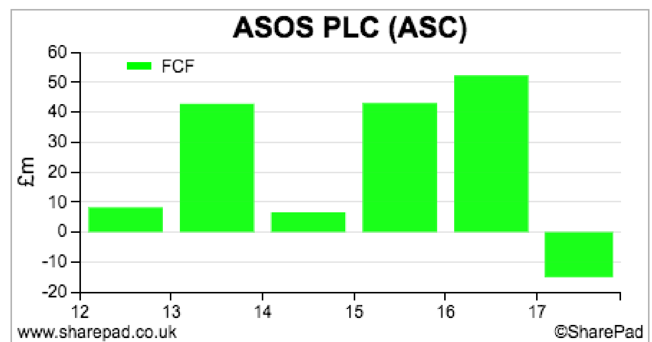
This improving capital turnover ratio is driving an improvement in ROCE during the last three years to over 25%. This is an impressive number and a confirmation of Asos' status as a high-quality company in my view.

The key test for the company going forward is whether these trends can be sustained whilst investment in warehouses and technology increases to accommodate the expected sales growth.

This cost is often overlooked by investors in internet retailers. They may not have the burden of running a chain of stores but money still needs to be spent on warehousing and technology assets in order to deliver growth.

Capex is eating up the company's trading cash flow and this trend should continue in 2018 as the capex bill is expected to increase from £160m to £200-£220m as new warehouse space is built out.





The higher capex meant that free cash flow turned negative in 2017 and I would expect a bigger free cash outflow in 2018.

Some investors get worried about negative free cash flow. Sure, you would rather a company could grow whilst generating free cash inflows but outflows are not a problem if the ROCE earned on the capex spent remains high. If Asos can earn 25% on its new investments then shareholders should be pleased.

ASOS PLC (ASC)

← Prev Next →	2015	2016	2017	2018	2019	2020
Fiscal period ending	31/8/15	31/8/16	31/8/17	1/8/18	1/8/19	1/8/20
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	1,143.0	1,444.9	1,923.6	2,427.6	2,989.8	3,678.4
Norm EBITDA	74.1	95.6	121.9	175.3	228.7	288.7
EBIT	51.0	63.8	79.6	99.3	120.4	153.2
EBIT margin	4.5	4.4	4.1	4.1	4.0	4.2
Norm Pre-tax	51.3	64.5	80.5	101.3	121.3	-
EPS(p)	47.7	67.8	77.2	97.2	117.5	149.5
EPS % chg	▲6.8	▲42.1	▲13.9	▲25.9	▲20.9	▲27.2

Analysts are expecting profit growth to track expected sales growth of around 25% for the next few years. That would be a very good result but it's hard to say that this scenario isn't already priced into the shares which trade on over 56 times 2018F EPS. At 5423p, the PE would still be over 36 times based on 2020F EPS - a little less if the net cash balances are adjusted for.

That said, there is no doubt that businesses such as Asos and boohoo.com are shaking up the world of young fashion retailing in a big way. They will surely keep growing in the years ahead as there is a lot of market share left for them to take. But investors are being asked to pay very high valuations to gain a share of it.

But if you wanted to do so as an investor, which share is the best bet? Both companies make very similar returns on capital (excluding leases) but do so in a different way. Asos has lower margins and a higher capital turnover than boohoo and is pursuing an aggressive volume approach to growing.

	ASC General Retailers ①	BOO General Retailers ①
HEADLINE		
Market cap	£4,580.3	£2,261.5
Enterprise value	£4,420.0 m	£2,207.1 m
Turnover	£1,923.6 m	£294.6 m
EPS	77.2p	2.2p
CONFIDENCE		
VALUATION		
fc PE	56.5 ★	65.7
EV / EBITDA	36.3 ★	63.3
EV / EBIT	55.5 ★	73.3
Price to FCF	-304.3	-3,920.8
FORECAST GROWTH %		
Turnover	26.2%	75.4% ★
EBIT	24.7% ★	22.6%
Pre-tax profit	26.6%	45.9% ★
Normalised EPS	25.9%	38.9% ★
SAFETY		
Fixed charge cover	10.0	18.4 ★
FCF conversion	-23.4%	-2.3% ★
Gearing	0.0% ★	12.3%
Beneish M-score	-1.62 ★	-0.46
DIVIDENDS		
QUALITY		
ROCE	30.8% ★	30.8% ★
EBIT margin	4.1%	10.2% ★
Capital turnover	7.4 ★	3.0
FCF margin	-0.8%	-0.2% ★

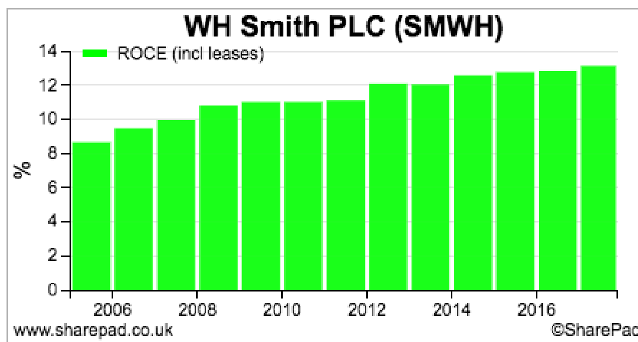
For me, the key test for boohoo is whether its profit margins can stay at a similar level to what it is earning now. The company has unnerved investors by suggesting that margins will edge down but sales growth will edge up. We have also yet to see the impact of new warehousing investment on boohoo's ROCE. Asos probably has to stop its margins going much lower.

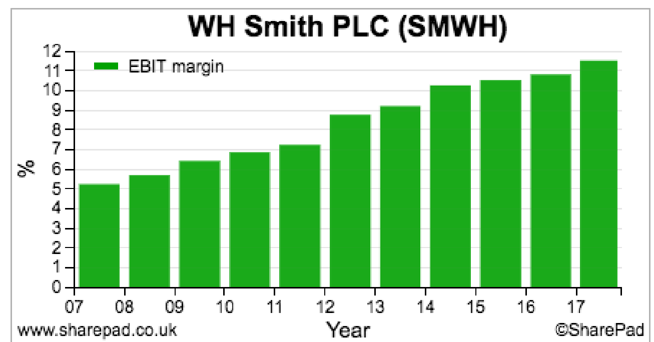
Both shares remain richly priced and leave no scope for disappointments. They are not for the nervous.

Share Discussion: WH Smith (LSE:SMWH)

WH Smith has spent the last decade defying the sceptics who see it as a high street retailing dinosaur. Its business performance has improved significantly from a low returning entity to very respectable one.

Its strategy of expanding its travel business has paid off handsomely. Having stores in areas of high footfall such as airports, train stations, hospitals and service stations where there is little competition has proven to be an excellent way to make money. Travel is now bigger than the high street business in terms of sales and profits.

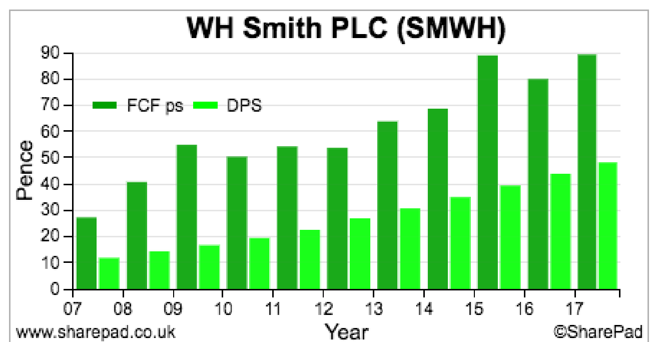




This is a high-quality business with 15% profit margins compared to 10% at the high street stores. The shift in profits towards Travel has been a big driver of improved profit margins overall.

In the high street business, the company has stop selling stuff that people don't want to buy and has concentrated on profitable sales. This has been helped by taking on Post Office branches as a driver of footfall. Profit margins have gone up as a result.

As a consequence, WH Smith has kept profits and free cash flows growing which has allowed growing dividends and share buybacks.

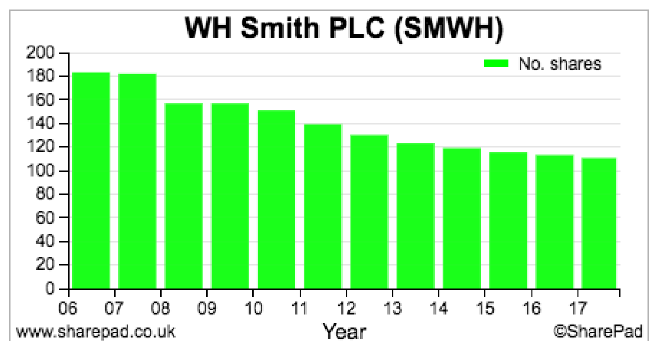


The company has returned over £900m to shareholders since 2007 and has just announced another £50m buyback.

The buybacks have allowed it to shrink its share count by over 40% which has made EPS growth easier to achieve.

Financial Year	Ordinary Dividend(4) GBPm	Buyback(6) GBPm	Special Dividend GBPm	Total GBPm
2018	53 (5)	50 (7)	-	c. 103
2017	50	41	-	91
2016	46	47	-	93
2015	42	54	-	96
2014	38	41	-	79
2013	34	50	-	84
2007 - 2012	147	173	57	377
	410	456	57	c. 923

The outlook for the travel business looks to be good. It now has 233 international stores with concession wins and franchises under development taking the number to 277. This nicely complements the 592 travel stores in the UK. Profits should keep growing going forward as long as passenger numbers do not fall.



But profits growth at the high street has stalled recently. Could it be that the company has run out of road on cost cutting and sales mix improvements after many years of successful efforts?

Looking at analysts' forecasts, growth is expected to slow down at the EPS line despite the positive impact of buybacks.

WH Smith PLC (SMWH)

← Prev Next →	2015	2016	2017	2018	2019	2020
Fiscal period ending	31/8/15	31/8/16	31/8/17	1/8/18	1/8/19	1/8/20
£ millions unless stated	Q4	Q4	Q4	Forecast	Forecast	Forecast
KEY FORECASTS						
Turnover	1,178.0	1,212.0	1,234.0	1,258.1	1,300.5	1,287.1
Norm EBITDA	160.0	169.0	183.0	190.0	199.6	-
EBIT	124.0	131.0	142.0	143.0	148.0	-
EBIT margin	10.5	10.8	11.5	11.4	11.4	-
Norm Pre-tax	121.0	129.0	136.0	145.2	148.9	155.0
EPS(p)	85.6	92.2	100.0	110.1	116.6	124.0
EPS % chg	▲10.2	▲7.7	▲8.5	▲10.1	▲5.9	▲6.3
Dividend per share Adj	39.4	43.9	48.2	51.0	53.2	57.4
Dividend per share %chg Adj	▲12.6	▲11.4	▲9.8	▲5.8	▲4.3	▲7.9
Dividend cover	2.2	2.1	2.1	2.2	2.2	2.2

The shares have been a terrific investment. They are up by a third in 2017 so far and have increased by more than fivefold since 2007 with some nice dividend income on top. However, at 19 times 2018F EPS these shares look to be fairly priced at best given the moderating growth outlook.

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