# Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

3rd November 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 | 7555.32 | ▲0.919 | ▲1.57 | ▲10.4 | 7556.24 | 6693.26 | 12/10/17 | 4/11/16 |
| 2 | FTSE 250 | 20385.5 | ▲1.1 | ▲2.15 | ▲16.7 | 20385.5 | 17271.2 | 2/11/17 | 4/11/16 |
| 3 | FTSE SmallCap | 5887.89 | ▲1.75 | ▲2.17 | ▲19.2 | 5887.89 | 4862.64 | 2/11/17 | 11/11/16 |
| 4 | FTSE AIM 100 | 5337.83 | ▲1.61 | ▲4 | ▲36.6 | 5344.52 | 3817.03 | 30/10/17 | 4/11/16 |
| 5 | FTSE All-Share | 4151.7 | ▲0.98 | ▲1.68 | ▲11.7 | 4151.7 | 3641.91 | 2/11/17 | 4/11/16 |
| 6 | S&P 500 | 2577.1 | ▲0.652 | ▲1.9 | ▲22.8 | 2581.07 | 2085.18 | 27/10/17 | 4/11/16 |
| 7 | Brent Oil Spot $ | $60.3755 | ▲1.57 | ▲7.69 | ▲28.3 | $61.165 | $44.565 | 31/10/17 | 11/11/16 |
| 8 | Gold Spot $ per oz | $1275.36 | ▲0.642 | ▲0.325 | ▼-1.79 | $1349.10 | $1128.22 | 7/9/17 | 15/12/16 |
| 9 | GBP/USD - US Dollar per British Pound | 1.30599 | ▼-0.53 | ▼-1.61 | ▲6.15 | 1.3591 | 1.20401 | 15/9/17 | 16/1/17 |
| 10 | GBP/EUR - Euros per British Pound | 1.12045 | ▼-0.696 | ▼-0.968 | ▲1.03 | 1.1972 | 1.0795 | 18/4/17 | 29/8/17 |

## Top Risers

| No. | TIDM | Name | %chg 1w |
|---|---|---|---|
| 1 | INDV | Indivior PLC | ▲21.1 |
| 2 | PMO | Premier Oil PLC | ▲16 |
| 3 | ZTF | Zotefoams PLC | ▲14.3 |
| 4 | LUCE | Luceco PLC | ▲13.3 |
| 5 | SIA | SOCO International PLC | ▲12 |
| 6 | GDWN | Goodwin PLC | ▲10.9 |
| 7 | FENR | Fenner PLC | ▲10.5 |
| 8 | HWDN | Howden Joinery Group PLC | ▲10.3 |
| 9 | SPT | Spirent Communications PLC | ▲10.2 |
| 10 | CNCT | Connect Group PLC | ▲9.51 |

## Top Fallers

| No. | TIDM | Name | %chg 1w |
|---|---|---|---|
| 1 | ELTA | Electra Private Equity PLC | ▼-46.2 |
| 2 | PTEC | Playtech PLC | ▼-19 |
| 3 | NANO | Nanoco Group PLC | ▼-11.7 |
| 4 | CTEC | ConvaTec Group PLC | ▼-8.99 |
| 5 | DEB | Debenhams PLC | ▼-8.2 |
| 6 | NXT | Next PLC | ▼-7.98 |
| 7 | ACA | Acacia Mining PLC | ▼-7.92 |
| 8 | DNLM | Dunelm Group PLC | ▼-7.25 |
| 9 | CARD | Card Factory PLC | ▼-5.94 |
| 10 | DC. | Dixons Carphone PLC | ▼-5.83 |

## Connect Group (LSE:CNCT)

Connect Group makes money by moving things from one place to another. Its biggest source of profit comes from distributing newspapers and magazines in the UK. It also distributes print and digital media to airlines and train companies and delivers bulky parcels - such as furniture and automotive parts - for businesses.

Its shares have been very unloved during most of 2017 as investors have questioned the company's strategy and its ability to grow profits going forward. Even a very big dividend hasn't stopped the shares cratering.

Connect's chief problem is that its core newspaper and magazine distribution business is in a long-term decline as more people read content on tablet computers and mobile phones. The company gets paid a percentage of the cover price of the newspaper or magazine but even though these have been going up for years it hasn't been able to offset the decline in the numbers of newspapers and magazines being bought by people.

This is a business that operates on wafer-thin profit margins and the company has had to be very good at taking out costs as revenues have fallen. As you can see from the table below, it has been very good at preserving the levels of profits from its news business.

**Connect: News Distribution (£m)**

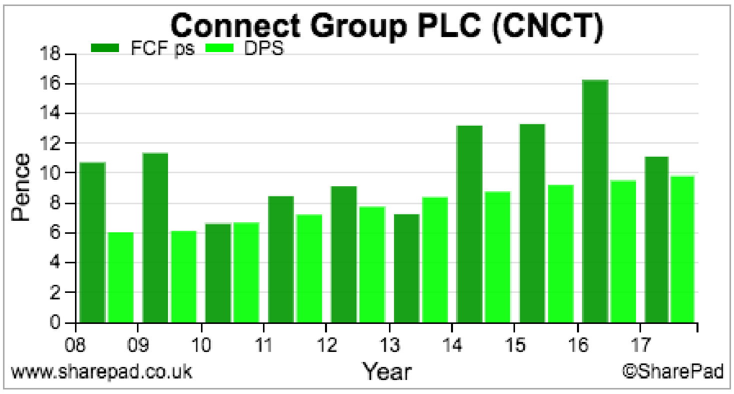
| Year | Sales | Op Profit | Margin | Change in sales | Change in costs | Change in profit |
|---|---|---|---|---|---|---|
| 2008 | 1240.6 | 32.5 | 2.62% | | | |
| 2009 | 1272.5 | 30 | 2.36% | 31.9 | 34.4 | -2.5 |
| 2010 | 1692.5 | 33.1 | 1.96% | 420 | 416.9 | 3.1 |
| 2011 | 1600.7 | 38 | 2.37% | -91.8 | -96.7 | 4.9 |
| 2012 | 1570.7 | 39 | 2.48% | -30 | -31 | 1 |
| 2013 | 1529.3 | 40 | 2.62% | -41.4 | -42.4 | 1 |
| 2014 | 1524.8 | 42.9 | 2.81% | -4.5 | -7.4 | 2.9 |
| 2015 | 1479.3 | 41.4 | 2.80% | -45.5 | -44 | -1.5 |
| 2016 | 1443.8 | 40 | 2.77% | -35.5 | -34.1 | -1.4 |
| 2017 | 1383.4 | 40.4 | 2.92% | -60.4 | -60.8 | 0.4 |

This is a business that looks as if it is running hard to stand still. However, management has actually done a great job with this business. This is because the profits have been depressed by the losses at its new business venture called "Pass my Parcel" which specialises in next day deliveries and returns of goods for companies such as Amazon and Asos.

Pass my Parcel made one million deliveries in 2017 and is currently operating at a run rate of two million per year. There is no doubt that there is growing demand for this kind of service but will it make any money for Connect's shareholders? Losses increased from £4m in 2016 to £6.3m in 2017. The company seems to be confident that these losses will come down and is still targeting break even for this business in 2019.

Time will tell if this is too optimistic but Connect's track record with new businesses has not been too good over the last few years. It has sold its Education business - which delivered books and stationery to schools - and has also puts its Books business up for sale.

Tufnells Parcels which was bought in 2015 is not doing very well. It saw profits fall by nearly 20% last year despite revenue growing by 5%. There are some problems with costs and capacity in this business as well as the overall culture within it. Investments made by Connect to increase profits have also proven to be disappointing.




Connect is looking to put this right by integrating it with the news business and stripping out £15m of costs in the process.

The problem is that cutting costs is not a sustainable long-term strategy as you always run out of costs to cut. Connect needs a genuine source of profitable sales growth and it is by no means certain that Tufnells' bulky parcel deliveries or Pass My Parcel is going to produce that.

The good news for shareholders is that they are getting a very nice dividend from the shares and this looks to be safe for the next few years at least.

The company has always been able to generate lots of free cash flow despite its low profit margins as it tends to rent rather than own its vans and warehouses. This keeps capex requirements reasonably low and helps with free cash generation which has funded a rising dividend payment.

If you have owned these shares for the last decade then all your returns have come from dividends. The share price is 5% lower than a decade ago but the total return from the shares has been a very respectable 58.6%.

At a share price of 112p, the shares offer a prospective dividend yield of 9.1% whilst trading on a prospective PE of just 6.8 times. The dividend costs around £24m a year and the good news for shareholders is that free cash flow is predicted by analysts to rise to give a nice buffer over this cost which will allow debt to come down as well (*see detailed diagram overleaf*).

To be frank, I can see a 10p per share dividend being affordable for a good few years yet unless the revenues at News Distribution really fall off a cliff. This suggests that dividend returns from owning the shares could be very decent indeed.

Predicting the trajectory of share prices is always difficult. There is no doubt that Connect looks to be a very cheap share on a PE and P/FCF basis. The trouble is that it has done for years and without meaningful growth may continue to stay that way. I also feel that this is a share that many investors buy because of its yield and cheapness and they get fed up with it and sell when it doesn't rerate upwards.

This will not bother patient dividend investors who can point to the very satisfactory long term total returns from owning the shares. That said, whether cost cutting can keep on delivering those dividends in the decade ahead as it has in the past remains to be seen.

It looks to be a tougher task to me but could be solved by Connect continuing to buy companies and strip out costs by integrating them with existing businesses. This is not a source of high quality earnings growth but at a valuation of 6.8x 2018F eps it doesn't need to be.

This is not a business for me but I can see why yield hunters might want to tuck a few Connect shares away in their portfolios.

## Connect Group PLC (CNCT)

| Opinion | | | Brokers | |
|---|---|---|---|---|
| | 1 | Buy | 2 | |
| | 2 | Out Perform | 2 | |
| | 3 | Hold | 0 | |
| | 4 | Under Perform | 0 | |
| | 5 | Sell | 0 | |
| | 0 | No Opinion | 0 | Not included in consensus |
| | **1.5** | **Buy** | **4** | **Consensus** |

## FORECASTS

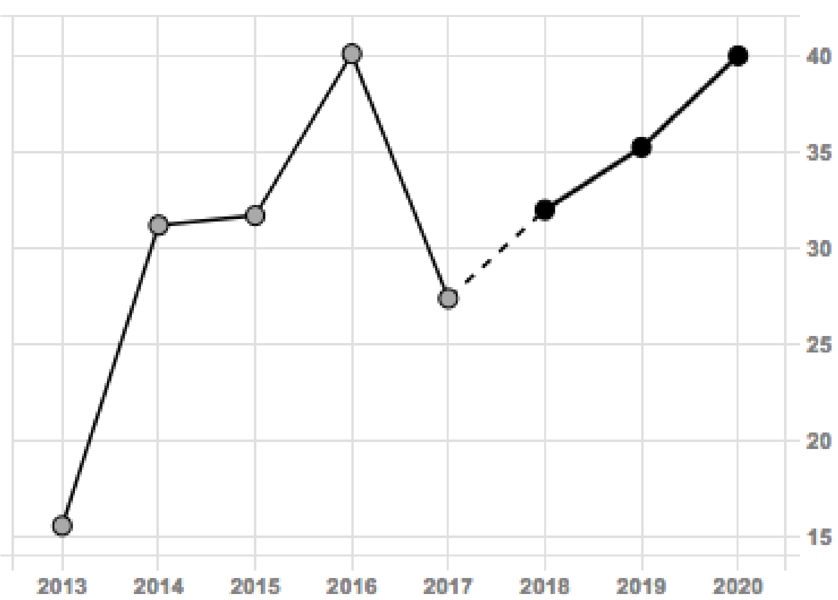
£ millions unless stated

| Year | 2018 | | 2019 | | 2020 | |
|---|---|---|---|---|---|---|
| Turnover | 1,560.5 | -2.1% | 1,641.0 | +5.2% | 1,492.1 | -9.1% |
| EBITDA | 77.1 | +27.4% | 75.5 | -2.1% | 76.0 | +0.7% |
| EBIT | 57.0 | +37.1% | 57.5 | +0.7% | 57.1 | -0.6% |
| Pre-tax profit | 50.3 | +41.0% | 52.3 | +3.9% | 51.4 | -1.7% |
| Post-tax profit | 40.6 | +43.0% | 41.4 | +2.0% | 41.7 | +0.6% |
| EPS (p) | 16.3 | +42.2% | 16.9 | +3.7% | 16.9 | 0.0% |
| Dividend (p) | 10.0 | +2.0% | 10.2 | +2.0% | 10.2 | 0.0% |
| CAPEX | 16.3 | -13.1% | 14.0 | -14.3% | 13.0 | -7.1% |
| Free cash flow | 32.0 | +16.8% | 35.3 | +10.2% | 40.0 | +13.5% |
| Net borrowing | 71.5 | -13.9% | 69.8 | -2.3% | 58.4 | -16.3% |
| NAV | - | | 41.0 | | 41.0 | 0.0% |
| LFL sales growth % | - | | - | | - | |

## FREE CASH FLOW

£

Target price
Turnover
EBITDA
EBIT
Pre-tax profit
Post-tax profit
EPS
Dividend
CAPEX
FCF
Net borrowing
NAV
LFL Sales %

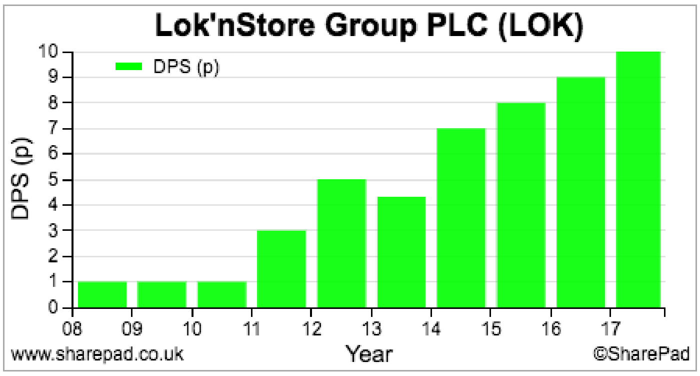


## Lok'n Store (LSE:LOK)

Lok'n Store is a fast growing self storage company. It provides self storage to private individuals (roughly two thirds of annual sales) and business customers (roughly one third of annual sales) mainly in the south east of England where demand for facilities is high. It also owns two document storage centres. It currently trades from 26 sites and has over 9500 customers.

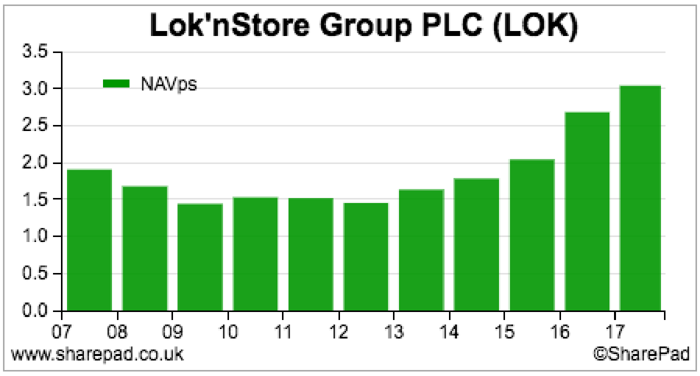

Lok'n Store is not a real estate investment trust (REIT) like many property companies are which means it does not have a preferential tax rate on its profits or capital gains on properties. Shareholders make money from the shares in a similar way to REITS by receiving dividends and a growing net asset value (NAV) per share which hopefully pushes the share price up.

The company has a good recent track record on both counts.




Dividend growth has been strong.

NAV growth has come from a growing asset base (more storage sites) and an increase in investment value from those sites. The latter has been helped by low interest rates and strong market demand for storage assets.

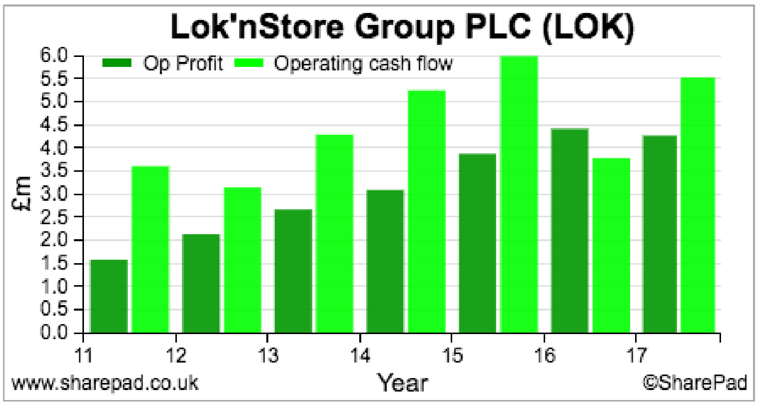



I'll have more to say on Lok'n Store's asset value very shortly.

It is a relatively simple business to understand with a simple four point strategy for growth:

1. Get more cash out of each storage site.
2. Build more storage sites.
3. Manage more storage sites for third parties to increase fee income.
4. Grow the document storage business.

Full year results announced this week point to a company that is in a very healthy state. Like-for-like revenue increased by 5.6%. The self storage business saw a 6.5% growth in occupancy to just under 70% (15 of the 26 sites have occupancies of over 70%) as it kept underlying price increases very low at 0.8%.




Reported operating profits were low due to the absence of a one-off gain made in 2016 but more importantly, operating cash flow - the cash which pays the dividend - was up nicely year on year (but not as high as it was a couple of years ago).

Lok'n Store has very low debts for a property business with debt to assets falling for the fifth consecutive year. Net borrowings came down thanks to £10m of treasury shares being sold to new investors whilst asset values also increased.

The outlook for this business looks to be good. The company has plenty of firepower - from a strong balance sheet and operating cash flows - to grow the number of sites and has 11 currently in the pipeline. This should feed through into higher operating cash flows and dividends going forward. As you can see from the forecasts below, dividend growth of around 10% per year is expected for the next three years according to analyst estimates (*see detailed diagram overleaf*).

I have to say that this is a business that I quite like the look of. The self storage market is growing whilst the company seems to have a strong and defendable market position in the south east where demand for storage is high. If demand for self storage in the UK was to approach the same levels per head of population as it does in the US then you can take a very bullish view on the company and its shares.

So are the shares good value or not?

Savvy investors will try to buy a property business for less than its NAV per share. When it comes to Lok'n Store there is some debate as to what its true NAV per share actually is.

Property investment companies have to revalue their properties every year which means that the balance sheet is helpful to outside investors in trying to work out how much the business and its shares might be worth.

If we look at the value of assets less liabilities this comes to £89.1m or 304p per share according to SharePad. This compares with a share price at the time of writing of 379p which doesn't make the shares look particularly cheap. Valuation of property for a company like Lok'n Store includes an estimation of the future income generated by each property. The property has been valued by property experts Jones Lang La Salle and assumes mature stabilised occupancy rates of 81% and a valuation yield (income as % of value) of 7.67%.

The company makes a pitch for arguing that its shares might be worth more. It argues that because seven of its sites are leased (rented), and therefore not included on the balance sheet, then the true value of the business is not being reflected. If the estimated £16.7m value of future income for the

## Lok'nStore Group PLC (LOK)

### BREAKDOWN

| Opinion | | | Brokers | |
|---|---|---|---|---|
| | 1 | Buy | 0 | |
| | 2 | Out Perform | 0 | |
| | 3 | Hold | 0 | |
| | 4 | Under Perform | 0 | |
| | 5 | Sell | 0 | |
| | 0 | No Opinion | 1 | Not included in consensus |
| | **0** | **No Opinion** | **1** | **Consensus** |

### FORECASTS

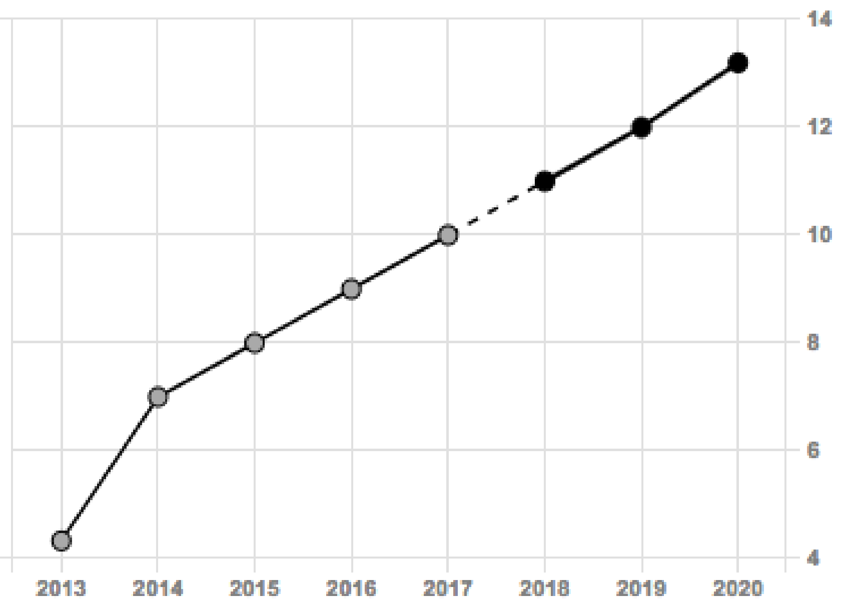
£ millions unless stated

| Year | 2018 | | 2019 | | 2020 | |
|---|---|---|---|---|---|---|
| Turnover | 17.7 | +6.3% | 19.1 | +7.9% | 20.5 | +7.3% |
| EBITDA | 7.3 | +16.2% | 8.2 | +12.3% | 9.3 | +13.4% |
| EBIT | 5.1 | +19.7% | 5.8 | +13.7% | 6.8 | +17.2% |
| Pre-tax profit | 4.5 | +12.2% | 5.2 | +15.6% | 6.3 | +21.2% |
| Post-tax profit | 3.6 | +26.8% | 4.2 | +16.7% | 5.1 | +21.4% |
| EPS (p) | 12.2 | +23.6% | 14.3 | +17.2% | 17.3 | +21.0% |
| Dividend (p) | 11.0 | +10.0% | 12.0 | +9.1% | 13.2 | +10.0% |
| CAPEX | 8.4 | +26.7% | 0.3 | -96.4% | 0.4 | +33.3% |
| Free cash flow | -3.4 | +57.7% | 5.5 | | 6.4 | +16.4% |
| Net borrowing | 23.8 | +37.7% | 21.7 | -8.8% | 19.0 | -12.4% |
| NAV | - | | - | | - | |
| LFL sales growth % | - | | - | | - | |

### DIVIDEND

£

Target price
Turnover
EBITDA
EBIT
Pre-tax profit
Post-tax profit
EPS
Dividend
CAPEX
FCF
Net borrowing
NAV
LFL Sales %



leased sites was added on, the NAV per share would increase to 351p. This seems fair enough to me.

Analysis of Total Property Value

| | No of stores/sites | 31 July 2017 Valuation GBP | No of stores/sites | 31 July 2016 Valuation GBP |
|---|---|---|---|---|
| Freehold & Long Leasehold valued by JLL(1) | 12 | 102,900,000 | 12 | 96,125,000 |
| Short Leasehold valued by JLL(2) | 7 | 16,725,000 | 7 | 16,575,000 |
| Freehold land and buildings at Director valuation (3) | 1 | 4,195,479 | 1 | 3,000,000 |
| Subtotal | 20 | 123,820,479 | 20 | 115,700,000 |
| Sites in development at cost | 2 | 5,124,567 | 2 | 457,826 |
| Total | 22 | 128,945,046 | 22 | 116,157,826 |

Then things start to get a little bit more complicated.

When property assets are revalued upwards it can result in an unrealised gain. This unrealised gain then creates a deferred tax liability (tax that would have to be paid on that gain if the property was sold). The deferred tax goes on the balance sheet as a liability and reduces NAV per share.

Lok'n Store argues that this tax will not be paid as the assets will not be sold. Any gains from assets sold would be reinvested into new stores and then incur something known as rollover relief which postpones the payment of deferred tax.

The company therefore ignores the deferred tax liability (just over £16m or £18m including the leased stores) and adds it back to NAV per share giving an adjusted value of 416p per share which makes the shares look better value.

I am happy to be corrected here as I am not a property expert but I am not sure I agree with this. It seems a bit like having your cake and eating it. I don't see how you can take the benefit of an upwards revaluation and ignore the tax liability it would create if the asset was sold.

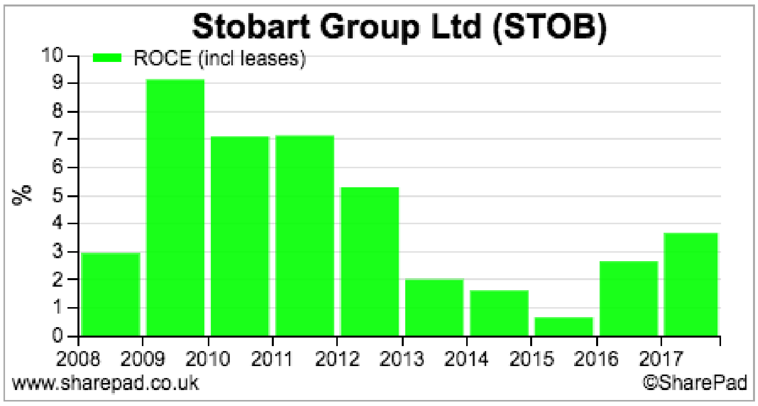
It's true the assets are not being sold but they are being valued at market value as if they were. To me, the adding back of deferred tax to NAV looks a touch optimistic. I'll leave you to make your own minds up on this matter.

Taking the NAV of 351p per share and the prospect of some decent dividend growth the shares don't look to be particularly expensive but are no bargain either. My caution would be the downside risk to NAV in the event of an economic downturn and a substantial increase in interest rates and property yields.

## Stobart (LSE:STOB)

A quick glance at some key numbers would probably make me dismiss Stobart as a potential investment in less than a minute. It has terrible returns on capital employed (ROCE) for starters.

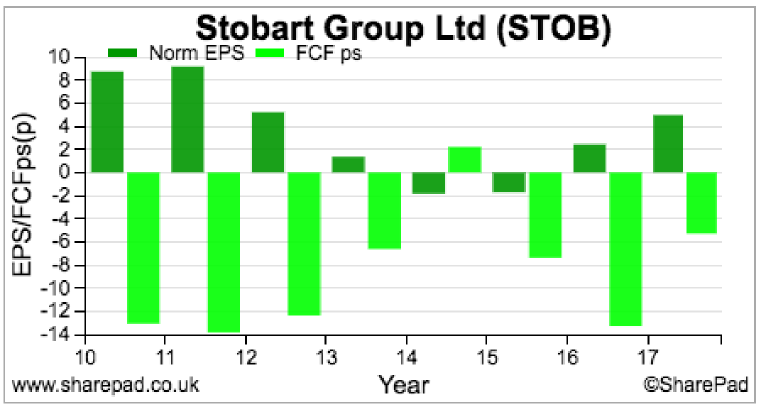

Its free cash flow performance is also horrendous with huge free cash outflows for many years.




Why would I or anyone else want to invest in a business like this?

Stobart's share price tells a very different story as the shares are up by more than 60% so far this year.

The company should not be confused with Eddie Stobart Logistics (LSE:ESL) which is famous for its distinctive trucks that are a familiar sight on our roads. Stobart has virtually sold out of this business now and retains a minority 12.5% stake.




The company has four main businesses:

1. Energy - sourcing and supplying biomass to power plants.
2. Aviation - it owns Southend and Carlisle airports, a regional airline business, and aircraft leasing and aviation services businesses.
3. Rail - civil engineering projects for its own businesses (biomass facilities at ports and rail facilities at airports. It also does work for Network rail.
4. Infrastructure - a portfolio of commercial properties and investments in renewable energy projects.

The company had no underlying profit during the first half of 2017. It posted a pre-tax profit of £122.2m of which £123.9m came from the disposal of a 49% stake in Eddie Stobart Logistics.

The company's dividend which gives a current yield of just over 6% is being paid for by asset disposals and possibly borrowing until 2022 when the company expects to have enough operating income to cover the cost.

Going by the performance of the share price so far this year, there seems to be a lot of confidence that Stobart is going to deliver. That said, a closer look at the business doesn't seem to be painting a glowing picture of trading at the moment with the exception of the Aviation division.

Divisional Underlying Profit Summary

| Divisional Underlying EBITDA(1) | 31 August 2017 GBPm | 31 August 2016 GBPm |
|---|---|---|
| Energy | 4.6 | 4.9 |
| Aviation | 6.2 | 1.0 |
| Rail | 1.4 | 1.0 |
| Investments | 124.6 | 5.2 |
| Infrastructure | 0.5 | 11.9 |
| Central costs and eliminations | (5.5) | (3.8) |
| Underlying EBITDA(1) (inc. GBP123.9m profit on disposal of investment) | 131.8 | 20.2 |

The Energy business has had a difficult time due to ongoing delays in commissioning new biomass plants and this has also increased costs. Margins have improved and the company remains confident in the long-term potential of this business.

| | 31 August 2017 | 31 August 2016 |
|---|---|---|
| Passenger numbers | 610,492 | 486,972 |
| Revenue per passenger | GBP21.03 | GBP22.67 |
| Load factor | 78.5% | 84.6% |
| On time performance | 84.9% | 85.9% |

The company is aiming to grow passenger numbers to 5 million per year by 2022. Current rates of growth are good - 25% during the first half of the year - with both easyJet and Flybe adding capacity next year which will add another 520,000 passengers per year.

Southend is becoming an attractive alternative to passengers and airlines as other London airports are heavily congested. If Southend can reach its passenger number target then there is no doubt that significant value can be created in my view. But it will require significant investment in things like new terminals to achieve that.

The other main source of value is the remaining 12.5% stake in Eddie Stobart Logistics which is worth around £70m at the current share price.

I must admit that without doing lots of research - especially into the potential value of Southend airport - then trying to work out whether Stobart is an attractive share or not is difficult.

Given there is not much income generation at the moment I am looking at net assets of £465m - which include a small net cash position - at the end of August 2017 compared with a current market capitalisation of just over £1bn.

EPS estimates for the year to February 2018 are misleading as they seem to include the huge one off profit from the sale of the ESL stake. Taking 2019F EPS of 7.9p puts the shares on over 36 times forecast earnings which can't really be considered to be cheap (*see detailed diagram overleaf*).

The cash from ESL and the £115m from the sale and leaseback of aircraft from its airline will cover the dividend cost of just over £60m this year but most of the cash windfall has gone on repaying debt. Current forecasts are for free cash flow of £53m by 2020 which still leaves the company borrowing or selling investments to pay its dividend.

I wouldn't mind owning a slice of Southend airport but it looks to me that a lot - if not all - of the potential value of it has been priced into the shares already.

## Stobart Group Ltd (STOB)

## BREAKDOWN

| Opinion | | | Brokers | |
|---|---|---|---|---|
| | 1 | Buy | 2 | |
| | 2 | Out Perform | 0 | |
| | 3 | Hold | 0 | |
| | 4 | Under Perform | 0 | |
| | 5 | Sell | 0 | |
| | 0 | No Opinion | 1 | Not included in consensus |
| | **1** | **Buy** | **3** | **Consensus** |

## FORECASTS

£ millions unless stated

| Year | 2018 | | 2019 | | 2020 | |
|---|---|---|---|---|---|---|
| Turnover | 264.8 | +104.7% | 346.2 | +30.7% | 366.3 | +5.8% |
| EBITDA | 151.8 | +372.5% | 43.3 | -71.5% | 54.5 | +25.9% |
| EBIT | - | | 32.0 | | 44.0 | +37.5% |
| Pre-tax profit | 135.7 | +606.5% | 32.3 | -76.2% | 43.2 | +33.6% |
| Post-tax profit | 132.0 | +674.1% | 27.1 | -79.5% | 35.0 | +29.2% |
| EPS (p) | 37.4 | +652.5% | 7.9 | -78.9% | 10.4 | +31.6% |
| Dividend (p) | 17.5 | +29.6% | 18.2 | +4.0% | 18.5 | +1.6% |
| CAPEX | 39.0 | +169.0% | 18.0 | -53.8% | 15.0 | -16.7% |
| Free cash flow | -12.9 | -28.6% | 31.9 | | 53.2 | +66.8% |
| Net borrowing | -39.6 | | -13.3 | -66.5% | -4.3 | -67.7% |
| NAV | - | | - | | - | |
| LFL sales growth % | - | | - | | - | |

## DIVIDEND

£

Target price
Turnover
EBITDA
EBIT
Pre-tax profit
Post-tax profit
EPS
Dividend
CAPEX
FCF
Net borrowing
NAV
LFL Sales %