Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

23 February 2018

In this week's newsletter I look at MJ Gleeson (GLE), Reckitt Benckiser (RB.), Dart Group (DTG), McColl's Retail Group (MCLS), Fidessa (FDSA), Intercontinental Hotels Group (IHG), Tristel (TSTL), Dunelm (DNLM) and Hotel Chocolat (HOTC).

Market Overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7238.16	▼-0.775	▼-6.38	▼-0.457	7778.64	7092.43	12/1/18	9/2/18
FTSE 250	19754	▲0.103	▼-4.44	▲5.96	20932.6	18588.6	5/1/18	24/2/17
FTSE SmallCap	5712.77	▼-0.888	▼-4.74	▲7.22	6038.69	5288.34	15/1/18	28/2/17
FTSE AIM 100	5382.9	▲0.249	▼-2.69	▲23.5	5550.39	4353.47	29/1/18	24/2/17
FTSE All-Share	3986.81	▼-0.635	▼-6.01	▲0.84	4268.89	3902.85	12/1/18	9/2/18
S&P 500	2703.96	▼-1.03	▼-4.76	▲14.4	2872.87	2328.95	26/1/18	13/4/17
Brent Oil Spot $	$66.215	▲2.07	▼-5.17	▲17.2	$70.72	$44.785	24/1/18	21/6/17
Gold Spot $ per oz	$1330.60	▼-1.23	▼-0.847	▲6.5	$1356.22	$1200.05	24/1/18	9/3/17
GBP/USD - US Dollar per British Pound	1.39587	▼-0.49	▼-0.383	▲11.2	1.42661	1.21561	1/2/18	9/3/17
GBP/EUR - Euros per British Pound	1.1342	▲0.372	▼-0.369	▼-4.38	1.1972	1.0795	18/4/17	29/8/17

Top FTSE All-Share rises

No.	TIDM	Name	%chg 1w
1	FDSA	Fidessa Group PLC	▲45.8
2	CNA	Centrica PLC	▲12.1
3	SPI	Spire Healthcare Group PLC	▲11.9
4	GOG	Go-Ahead Group (The) PLC	▲10.6
5	EVR	Evraz PLC	▲9.53
6	GLE	MJ Gleeson PLC	▲9.28
7	PHNX	Phoenix Group Holdings	▲8.62
8	STVG	STV Group PLC	▲7.58
9	ICP	Intermediate Capital Group PLC	▲7.06
10	ENQ	EnQuest PLC	▲6.64

Top FTSE All-Share fallers

No.	TIDM	Name	%chg 1w
1	AA.	AA Ltd	▼-24.9
2	MONY	Moneysupermarket.com Group...	▼-14
3	FGP	FirstGroup PLC	▼-13.4
4	ACA	Acacia Mining PLC	▼-12.5
5	NTG	Northgate PLC	▼-11.9
6	DNLM	Dunelm Group PLC	▼-11.2
7	RB.	Reckitt Benckiser Group PLC	▼-10.2
8	HOC	Hochschild Mining PLC	▼-9.46
9	ALM	Allied Minds PLC	▼-9.38
10	NANO	Nanoco Group PLC	▼-8.61

MJ Gleeson (LSE:GLE)

Share price: 722p

Mkt Cap: £395.2bn

EMS: 750

No of analysts: 4

MJ Gleeson is a slightly different kind of housebuilder compared with its quoted peers. It primarily focuses on selling affordable houses on brownfield sites in the north of England and the north midlands. It builds the kind of houses that many of the bigger builders don't want to build because there is not enough money in it for them.

It also makes money by buying land and selling it to other builders in other parts of the country.

Like most house building companies, Gleeson has been doing well in recent years due to having lots of assistance from the government's Help to Buy scheme.

Unlike the big builders who are using price and mix (bigger houses) to increase their profits, Gleeson is making more money largely due to selling more homes.

Half year results announced this week showed that revenue growth of 34.7% from Gleeson Homes came from selling 31.5% more houses (593) with average selling prices increasing by just 2.5% to a very modest £124,000. Operating margins did increase from 15.5% to 16.7% which led to a boost in operating profits by 44.7% to £12.3m.

63% of the homes sold benefitted from Help to Buy down from 66% a year ago which shows how reliant that Gleeson is on this scheme.

The company is ramping up its number of building sites and has boosted the number of plots that it can potentially build on to 12,001. Gleeson has an ambitious plan to double its home sales to 2,000 per year by 2022 and is looking to expand outside its current geographic heartland in order to do so.

I think this is a very attractive strategy. One of the key weaknesses of the Help to Buy scheme is it has done little to address the shortage of affordable housing across the country. In a lot of cases,

it has just pushed up house prices whilst allowing buyers to take on increasingly large mortgages in order to buy new homes.

The chief beneficiaries have been the house builders whose profits and share prices have increased significantly since the scheme was introduced in 2013. This is evidenced by the fact that their revenues have increased much faster than the number of extra houses they have built.

Gleeson is not pursuing this kind of strategy, and providing it can get its hands on enough land with planning permission, I think its hopes could not only pay off but also mean that its profits will be a lot more resilient than its peers if house prices fall. The good news is that the company is still saying that land is still available to it at sensible prices.

The company's land buying business in the south of England had a quiet first half with profits falling from £2.3m to £1.7m. The second half of the year looks like it will be busier. Gleeson has a 74% beneficial interest in 21,400 plots that can be sold which represents a good source of incremental value for shareholders.

Dividend payments are also going up as dividend cover is being reduced slightly. This, combined with the increase in profits saw a 38.5% increase in the first half dividend.

MJ Gleeson PLC (GLE)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	180.3	+12.4%	205.9	+14.2%	231.6	+12.4%
EBITDA	36.7	+8.8%	40.5	+10.4%	44.8	+10.6%
EBIT	35.7	+8.6%	39.5	+10.7%	43.8	+10.7%
Pre-tax profit	36.0	+9.2%	39.6	+10.2%	44.0	+11.0%
Post-tax profit	28.6	+8.0%	32.0	+11.7%	35.6	+11.2%
EPS (p)	53.1	+9.9%	58.3	+9.8%	64.5	+10.6%
Dividend (p)	25.7	+7.1%	27.8	+8.2%	30.3	+9.0%
CAPEX	0.8	-32.2%	0.8	0.0%	0.8	0.0%
Free cash flow	14.4	-21.7%	16.5	+14.6%	19.3	+17.0%
Net borrowing	-34.4	+1.2%	-35.8	+4.0%	-38.1	+6.2%

This company looks to be in very good shape with analysts expecting continued strong revenue and profits growth. It also has an ungeared balance sheet.

I don't generally like house building shares due to their cyclicality and reliance on subsidised mortgages. This is also true in the case of Gleeson but I feel that it has a more sustainable business model than many of its peers.

The shares are not cheap, trading on a one year rolling forecast PE of 12.8 times and a 2.3 times the value of its latest shareholders' equity.

Reckitt Benckiser (LSE:RB.)

Share price: 5924p

Mkt Cap: £41.7bn

EMS: 300

No of analysts: 25

Branded consumer goods companies such as Reckitt Benckiser and Unilever have been lauded by advocates of quality investing as dependable long-term investments. This is because they sell goods that attract loyal customers who make lots of repeat purchases. This in turn leads to highly predictable revenues, high profit margins, high ROCE and lots of free cash flow.

As a practitioner of quality investing, these are the kind of businesses that I should like, but I don't.

Not so long ago, I would have agreed that companies such as RB and Unilever were exactly the type of companies to stick in your portfolio and forget about. Now, I think that their business models are badly broken and ill equipped to thrive in a word of changed consumer shopping habits since the financial crisis.

In short, I think many of the products they are selling are commoditized and overpriced. Own label products from supermarkets have come on leaps and bounds in terms of quality during the last decade and do the same or better jobs for consumers for a lot lower prices.

Just take some of the stalwarts of Reckitt's brand portfolio such as Nurofen, Dettol, Strepsil, Gaviscon and Finish as examples of this. Go onto a supermarket website and compare the prices of these products with own label equivalents. Here's an example from Morrisons:

RB Brands vs Morrisons own label

Nurofen 16 x 200mg	£1.97	Ibuprofen 16 x 200mg	32p
Dettol Spray 500ml	£2	Antibacterial Spray	77p
Gaviscon Liquid	£1.58 per 100ml	Heartburn and Indigestion	£1 per 100ml
Finish Powerball All in 1 Max	38.7p each	Powerburst	18.2p each
Strepsils	9.7p each	Sore Throat Lozenges	6.2p each

Some of you might scoff at me comparing Finish dishwasher tablets with Morrisons premium own label product. As far as the Oakley house's dishwasher is concerned there is no comparison - the Morrisons tablets clean far better.

Many consumers in the western world are strapped for cash with stagnant wages and incomes. They are increasingly not going to be buyers of RB brands when cheaper stuff will do the same job. Brands may have an appeal in the growing economies of Asia but how long will that last?

Like-for-like sales growth across Reckitt's brand portfolio last year was just 2%. When adjusted for exchange rates, there was no growth at all. Yet, the company reckons it will grow underlying sales by 2-3% in 2018. I wouldn't bet on that happening. I therefore think consensus estimates for LFL sales are too high for this company which brings into question the viability of profit forecasts.

Reckitt Benckiser Group PLC (RB.)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	12,814.3	+11.3%	13,341.0	+4.1%	13,790.2	+3.4%
EBITDA	3,722.4	+25.8%	4,005.8	+7.6%	4,265.3	+6.5%
EBIT	3,427.1	+25.2%	3,687.4	+7.6%	3,910.8	+6.1%
Pre-tax profit	3,124.9	+14.0%	3,408.0	+9.1%	3,659.6	+7.4%
Post-tax profit	2,407.1	+17.2%	2,647.9	+10.0%	2,897.0	+9.4%
EPS (p)	344.8	+19.4%	372.5	+8.0%	405.5	+8.9%
Dividend (p)	171.6	+4.4%	189.1	+10.2%	208.1	+10.0%
CAPEX	354.0	+1.4%	325.7	-8.0%	301.2	-7.5%
Free cash flow	2,147.0	+0.8%	2,734.3	+27.4%	3,105.0	+13.6%
Net borrowing	10,625.0	-1.0%	8,941.1	-15.8%	6,939.5	-22.4%
NAV	9,718.0	-28.2%	10,817.0	+11.3%	-	
Like for like sales growth %	3.3		3.9	+17.3%	5.0	+29.5%

Profit growth is increasingly dependent on cost cutting. Last year RB bought Mead Johnson - a baby food business - for a very expensive price tag considering that it was a shrinking business. Cost cutting here may bring some relief but this acquisition is going to drag down RB's ROCE.

The shares are understandably having a tough time but still trade on a one year forecast rolling PE of around 17 times. Given the outlook for sales and the low quality sources of profits growth that doesn't look really cheap by any means.

RB is not a bad business but it has a growth problem. It makes me wonder if the company could itself be the target of a takeover for Warren Buffett and his friends in the future.

Dart Group (LSE:DTG)

Share price: 797p

Mkt Cap: £1.18bn

EMS: 3000

No of analysts: 2

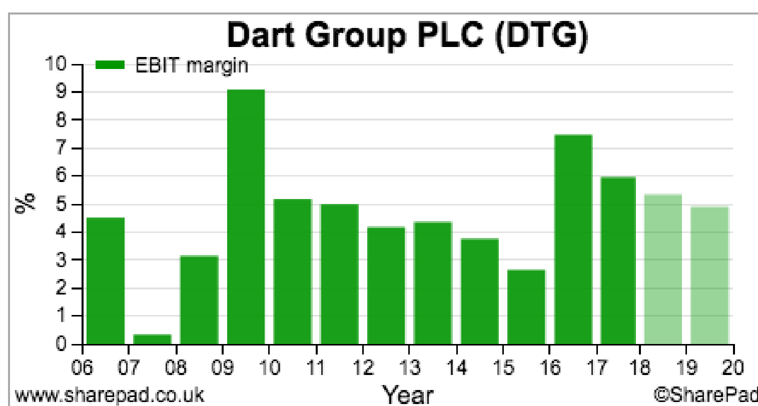
Dart Group makes money from running two separate businesses. Jet2.com is a tourist airline operating on routes to Mediterranean resorts and European cities. The Jet2 brand is also used to sell package holidays.

The company also has a fleet of trucks and warehouses to distribute fruit and vegetables around the country.

These two industries have historically been quite difficult places to make decent profits through good times and bad. Airlines and tour operators have often been bad at matching supply and demand for their services which has frequently led to heavy discounting of prices and a big hit to profitability.

Virtually all Dart's profits come from its airline and package holiday business with Distribution making a very small contribution.

Dart would not pass my quality threshold due to the volatility of airline profits and the fact that its operating margins are quite low at around 6%.



This week's trading update contained mixed news for investors. Current trading has been good, mainly due to the absence of a price war in the airline business. This has been helped by the bankruptcy of Monarch which has taken capacity out of the market. Consequently, profits for its 2017/18 financial year are expected to be materially ahead of current market expectations.

This is tempered by a more cautious outlook on 2019. Forward bookings for the Leisure and Travel business are described as “satisfactory” whilst the company is cautious on pricing. Given that the company is expanding its airline operations, the extra sales that will come from this means that at the moment profits for 2019 are expected to be in line with current expectations.

Dart Group PLC (DTG)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	2,398.5	+38.7%	2,855.0	+19.0%	3,136.0	+9.8%
EBITDA	259.0	+36.3%	268.0	+3.5%	278.4	+3.9%
EBIT	128.0	+24.3%	140.0	+9.4%	-	
Pre-tax profit	113.0	+25.4%	110.0	-2.6%	119.7	+8.8%
Post-tax profit	-		-		-	
EPS (p)	62.7	+24.7%	61.0	-2.7%	67.3	+10.3%
Dividend (p)	5.9	+11.9%	6.6	+11.9%	7.1	+7.6%
CAPEX	431.4	-9.0%	213.1	-50.6%	100.0	-53.1%
Free cash flow	-143.2	+0.2%	7.3		128.9	+1665.8%
Net borrowing	-156.0	-7.4%	-160.0	+2.6%	-	

The company’s investment in new airport bases at Birmingham and Stansted should give it a platform for future profits growth providing that it can fill its planes at sensible prices. The key threat to this business is that demand for holidays and tourism softens. If it does then Jet2.com will have to slash prices which given its very high fixed cost base will feed through to a big fall in profits.

City analysts are currently taking a cautious view on profitability with not much growth expected over the next couple of years.

Dart is not a bad business and its shares have rewarded long term investors - albeit with a bumpy ride along the way. That said, I do not believe that its business is of sufficient quality to command a very high valuation for its shares.

At 778p, the shares trade on a one year forecast rolling PE of 13 times. However, there is over £1 per share of net cash on the balance sheet. Strip this out and the PE falls to 11 times. That doesn’t look expensive by any means but in the absence of profit forecast upgrades the shares may struggle to take off from current levels.

McColl's Retail Group (LSE:MCLS)

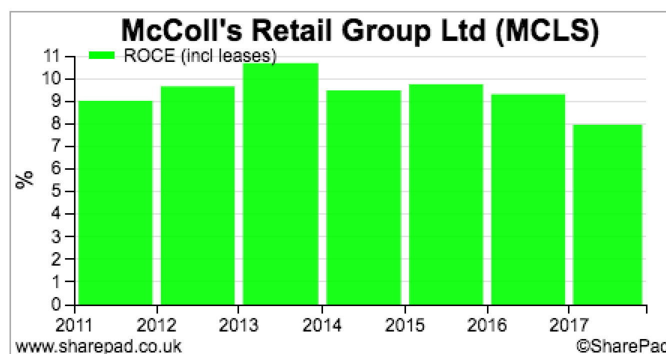
Share price: 240p

Mkt Cap: £280bn

EMS: 1500

No of analysts: 4

Convenience stores have been one of the success stories for UK grocery retailers in recent years. They have tapped into a growing trend amongst households to do more frequent and local top up shopping in addition to a big weekly grocery shop.



There's no doubt that they have been great for consumers but whether they are great for investors is not clear cut. Morrisons could not get convenience stores to work for it and quickly sold off its stores to a buyer that subsequently went bust.

McColl's has tried to cut out a profitable niche for itself as a standalone convenience store business but it has been hard work. Until last year, trading profits (EBIT) have essentially gone nowhere for years and have stayed in the low twenty millions of pounds. Profit margins have been very low.

The company rents most of its stores. When these are taken into account, the return on capital employed (ROCE) earned by the business has been very modest and certainly nothing to shout about.

McColl's has tried to buy itself some growth by acquiring 298 stores from the Co-op and entering into a new wholesale food supply

Agreement with Morrisons. The hope is that this will improve the quality of the business and make it more attractive to customers. However, this week's 2017 results announcement suggests that it is going to have its work cut out to improve its profitability.

Profit margins are expected to increase for a number of reasons.

The increase in the number of stores to nearly 1300 should help profit margins as the bigger business should have better buying power with suppliers. An improvement in sales mix towards fresher grocery products should also boost margins. Also, the quality of the store estate should improve as more newsagents are closed and convenience stores become a bigger part of the business.

Despite this, I think McColl's is going to find things tough going forward. Like-for-like sales last year barely increased, but refurbished stores saw LFL sales grow by just over 2%. All the profits growth came from the acquired Co-op stores

2018 has seen underlying sales hit a rocky patch as the bankruptcy of distributer Palmer & Harvey has disrupted sales in some stores but this problem has now been sorted out. However, my concern is that McColl's has become a less competitive business despite getting bigger.

The takeover of Booker by Tesco will increase the competitiveness of the Premier brand of convenience stores whilst the purchase of Nisa by the Co-op makes them stronger. It remains to be seen whether having Morrisons supply Safeway branded goods is going to feed through to meaningful underlying sales growth for McColls.

The company is frequently mentioned as a takeover target by pundits. It would not be surprising if Sainsbury's had run its slide rule over McColl's but no bid has been forthcoming. It is possible that the Morrisons supply deal effectively blocks this from happening now.

One thing to keep an eye on is that McColl's now has quite a lot of debt. Its forecast net debt to EBITDA ratio is 2.4 times for 2018. This is not dangerously high but it does add some financial gearing to its profits on top of its already substantial operational gearing. If underlying sales start to grow significantly then shareholders will be happy, but if they don't then they might start to wince.

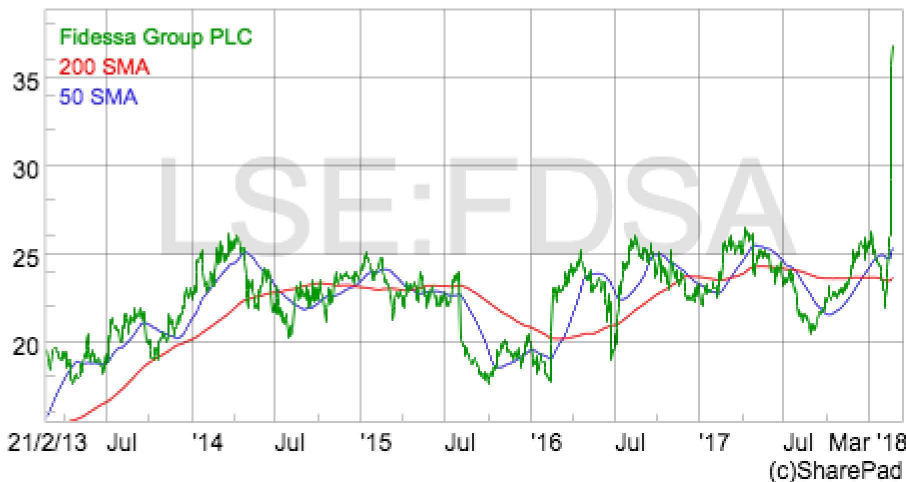
McColl's Retail Group Ltd (MCLS)

FORECASTS £ millions unless stated

Year	2018		2019	
Turnover	1,226.3	+8.4%	1,288.7	+5.1%
EBITDA	51.6	+37.8%	57.3	+11.1%
EBIT	36.1	+65.4%	38.2	+5.9%
Pre-tax profit	28.9	+23.2%	34.5	+19.1%
Post-tax profit	-		-	
EPS (p)	20.7	+24.2%	24.2	+16.9%
Dividend (p)	10.9	+5.8%	11.5	+5.5%
CAPEX	-		-	
Free cash flow	-		-	
Net borrowing	123.0	-11.3%	110.1	-10.5%

Takeover potential aside, I think it's quite difficult to make a bullish long term case for McColl's shares. The forecast rolling PE ratio of 11.3 times looks about right.

Fidessa (LSE:FDSA)



Share price: 3675p

Mkt Cap: £1.42bn

EMS: 300

No of analysts: 6

I thought I'd briefly mention financial software company Fidessa this week as i believe it may contain an interesting lesson for investors.

Fidessa sells its software to financial services companies who use them in areas such as trading, market data and regulation. The company has been a steady performer with growth in its sales and profits picking up during the last couple of years.

This week the company has been in the news for two reasons. Firstly it announced a decent set of full year results for 2017 which was then swiftly followed by a takeover bid for the company. This valued the company at over 36 times its forecast EPS for 2018.

Given that Fidessa is not expected to grow its profits rapidly over the next few years it does beg the question as to why someone is prepared to pay what seems to be a very rich price for the business.

I can think of quite a few reasons why:

Software subscriptions create highly predictable revenue streams. This level of certainty is generally valued highly by investors. Software itself can also be a very profitable business. Once revenues have covered a large amount of fixed costs, extra sales add large amounts of incremental profits.

The businesses don't tend to have high regular capital investment requirements. This can help them generate lots of free cash flow and earn decent levels of ROCE.

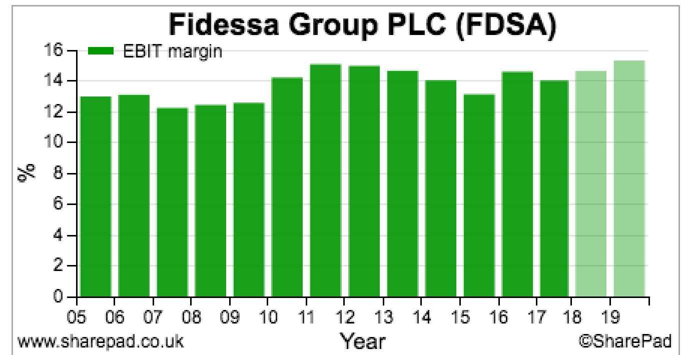
If we look at some of the key numbers relating to Fidessa's financial performance you can quickly see it has many of the hallmarks of a very high quality business.

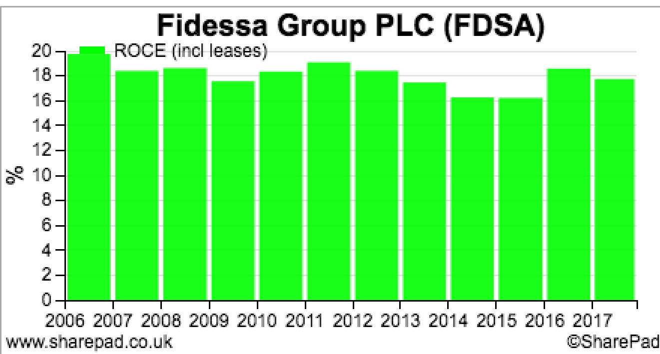
It has high and stable profit margins.

High and stable ROCE.

It tends to have free cash flow greater than its profits.

On top of all that, it has no debts and a decent cash balance.

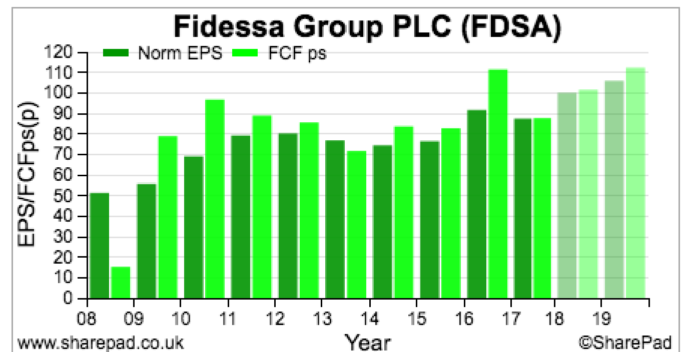




The point I want to make is that these kind of businesses with these financial characteristics are very rare. You won't find many like this listed on the London market.

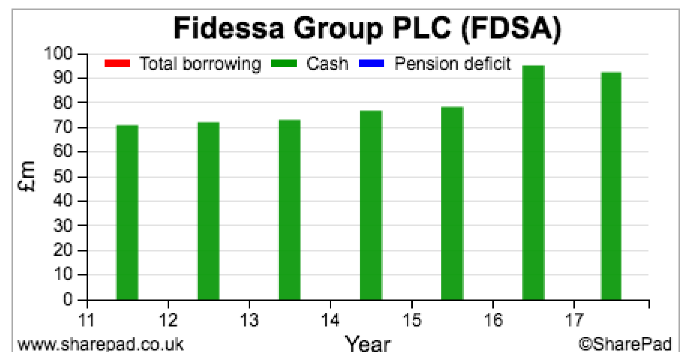
This scarcity is what goes a long way to justifying the very high price offered for Fidessa shares. You can then argue that a buyer can make cost savings and selling efficiencies that add more value.

In my opinion, the bid for Fidessa is an example of how stock markets can undervalue high quality businesses even when they were trading on high price to earnings multiples. It is a reason why I follow a high quality investment approach.



You can make an argument for saying that the bidder is massively overpaying for Fidessa and might struggle to make a reasonable return on its investment. I think this is a valid argument and certainly would concern me if I owned shares in the bidding company Temenos.

Shareholders in Fidessa will be very happy and given that the current share price is above Temenos' offer there may be grounds for further celebration in the the not too distant future. Activist investor, Elliott announced on Wednesday morning that it has built a stake of 4.9% in Fidessa and will be presumably be pushing the company to hold out for a higher price.



Fidessa Group PLC (FDSA)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	349.7	-1.2%	361.4	+3.3%	379.9	+5.1%
EBITDA	77.8	-12.7%	83.8	+7.7%	83.6	-0.2%
EBIT	51.2	+3.2%	55.3	+8.1%	60.5	+9.4%
Pre-tax profit	52.7	+5.5%	55.9	+6.1%	61.1	+9.4%
Post-tax profit	45.0	+32.3%	43.4	-3.6%	50.1	+15.5%
EPS (p)	100.0	+14.4%	105.9	+5.9%	118.6	+12.0%
Dividend (p)	96.9	+115.3%	87.1	-10.1%	86.5	-0.7%
CAPEX	13.6	-73.1%	13.1	-3.7%	13.5	+3.1%
Free cash flow	39.5	+15.8%	43.7	+10.6%	49.2	+12.6%
Net borrowing	-93.0	+0.7%	-97.1	+4.3%	-106.5	+9.7%
NAV	168.8	+1.3%	173.3	+2.6%	183.8	+6.1%

The other lesson from Fidessa is to be patient and hang on to shares in high quality businesses. I sold my shares in Fidessa last year in order to buy something else. I had been thinking about buying them back over last weekend but never pulled the trigger in time. Don’t feel sorry for me.

Intercontinental Hotels Group (LSE:IHG)

Disclosure: I own shares in IHG

Share price: 4631p

Mkt Cap: £8.7bn

EMS: 500

No of analysts: 24

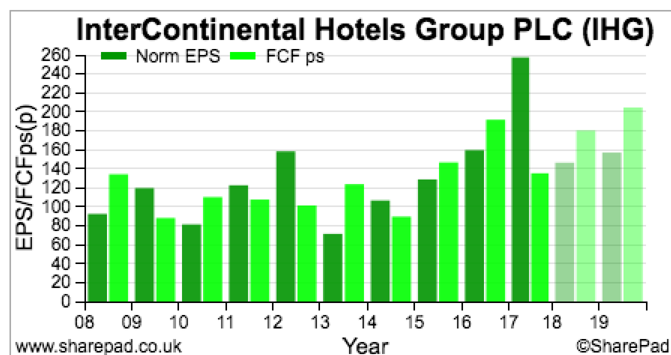
Since it made the decision to sell off most of its hotels and become a franchisor, IHG has been a very high quality business. It has very high operating margins, high returns on capital and generates lots of free cash flow. As well as franchising, the company also manages, owns and leases some hotels.

Franchising can be a very profitable business. Most of the costs of running IHG's hotels are incurred by the franchisees who get to keep the profits. The profits are after they have also paid a royalty payment back to IHG in return for access to its network and help with bookings and branding. The margins on these royalty payments for IHG are more than 50% and have been growing steadily in recent years and are expected to keep on doing so has hotel revenues grow.

High ROCE is a function of high profit margins and an asset light business.

Unlike owned hotels which have high capex requirements, IHG as a franchisor does not as the franchisee picks up most of the bill/ This allows IHG to convert most of its profits into free cash flow.

The bulk of the company's revenue comes from the Holiday Inn (business and leisure hotels), Holiday inn Express (budget hotels like Premier Inn), InterContinental (luxury) and Crowne Plaza (business) brands. Kimpton, Staybridge and Candlewood are luxury hotels which the company is keen to have more of.



Of the $25.7bn of gross revenue generated by IHG's hotels in 2017, $1784m of it accrued to the company (just under 7%). Fee income from franchisees and management contracts was the biggest slice of it at $1437m. Both revenue and fee income increased by 4%.

Three quarters of the company's profits are made in the Americas. All geographic areas grew their profits in 2017 with group operating profit growing by 7.4%, helped by a chopping of central overheads. This led to a further improvement in operating margins.

Group total gross revenue(a)	12 months ended 31 December 2017 $bn	2016 $bn	% change
InterContinental	4.8	4.6	4.3
Kimpton	1.1	1.1	–
Crowne Plaza	4.3	4.1	4.9
Hotel Indigo	0.4	0.4	–
Holiday Inn	6.3	6.2	1.6
Holiday Inn Express	6.7	6.3	6.3
Staybridge Suites	0.9	0.8	12.5
Candlewood Suites	0.8	0.7	14.3
Other	0.4	0.3	33.3
Total	25.7	24.5	4.9

Appendix 4: Full Year financial headlines

Operating Profit $m	Total 2017	Total 2016	Americas 2017	Americas 2016	Europe 2017	Europe 2016	AMEA 2017	AMEA 2016	G. China 2017	G. China 2016
Franchised	707	693	606	600	85	78	14	12	2	3
Managed	255	239	65	64	26	22	91	89	73	64
Owned & leased	31	26	29	24	–	–	2	2	–	–
Regional overheads	(124)	(123)	(56)	(55)	(25)	(25)	(20)	(21)	(23)	(22)
Profit pre central overheads	869	835	644	633	86	75	87	82	52	45
Central overheads	(110)	(128)	–	–	–	–	–	–	–	–
Operating profit before exceptional items	759	707	644	633	86	75	87	82	52	45
Exceptional items	4	(29)	37	(29)	(2)	–	(2)	–	–	–
Total operating profit	763	678	681	604	84	75	85	82	52	45

The best way to check on how well a hotel is doing is to look at how full its hotels have been (occupancy) and how much it is charging for rooms (room rate). Multiplying room rate and occupancy gives revenue per available room or REVPAR for short.

All regions saw REVPAR growth in 2017 with only Asia and the Middle East seeing a decline in room rate. With exception of Europe, the fourth quarter saw a stronger REVPAR performance with occupancies up which is a good sign.

Appendix 1: RevPAR Movement Summary

	Full Year 2017			Q4 2017		
	RevPAR	Rate	Occ.	RevPAR	Rate	Occ.
Group	2.7%	1.1%	1.1%pts	4.0%	2.0%	1.4%pts
Americas	1.6%	1.2%	0.3%pts	3.5%	2.1%	0.9%pts
Europe	6.3%	3.4%	2.0%pts	5.6%	3.3%	1.6%pts
AMEA	1.5%	(0.9)%	1.7%pts	2.6%	(0.1)%	2.0%pts
G. China	6.0%	0.4%	3.5%pts	7.3%	2.8%	2.9%pts

IHG has a strong pipeline of hotels waiting to join its franchising and management system.

Appendix 3: Full Year System & Pipeline Summary (rooms)

	System					Pipeline	
	Openings	Removals	Net	Total	YoY%	Signings	Total
Group	48,187	(17,247)	30,940	798,075	4.0%	83,481	244,146
Americas	21,615	(12,148)	9,467	497,460	1.9%	37,419	109,104
Europe	4,917	(1,571)	3,346	113,415	3.0%	9,241	25,988
AMEA	11,085	(1,475)	9,610	85,661	12.6%	12,620	37,370
G. China	10,570	(2,053)	8,517	101,539	9.2%	24,201	71,684

The company wants to expand significantly in China as well as adding more posh hotels. That said, a large chunk of growth is coming from the budget Holiday Inn Express brand,

The company seems well placed to keep on growing but there are some concerns that IHG may have to spend more money in order to do so. The company is increasing its investment in technology to boost its branding, marketing and loyalty schemes. It is also spending $200m to save $125m of costs.

Global pipeline at 31 December	Hotels 2017	Hotels Change over 2016	Rooms 2017	Rooms Change over 2016
Analysed by brand				
InterContinental	63	1	17,353	(127)
Kimpton	18	–	2,796	(302)
HUALUXE	21	(1)	6,289	(667)
Crowne Plaza	86	(4)	23,047	(1,489)
Hotel Indigo	82	7	11,301	708
EVEN Hotels	12	6	2,110	1,330
Holiday Inn(1)	277	16	53,556	878
Holiday Inn Express	766	90	93,360	9,478
avid hotels	44	44	4,043	4,043
Staybridge Suites	160	20	17,941	2,620
Candlewood Suites	112	4	10,009	405
Other	14	2	2,341	(2,807)
Total	1,655	185	244,146	14,070
Analysed by ownership type				
Franchised	1,223	184	139,348	21,654
Managed	432	1	104,798	(7,584)
Total	1,655	185	244,146	14,070

This will act as a drain on the company's short term free cash flow which has led to the company not paying a special dividend to shareholders as it has done in the last five years. This disappointed some people and led to a sharp sell off in the shares on the day the results were announced.

Personally, I think that the investment in the business is no bad thing if it will make the company stronger in the future.

IHG shares are not cheap on a rolling one year PE of 22 times but it is a rare example of a high quality business on the London market.

InterContinental Hotels Group PLC (IHG)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	1,345.5	+1.4%	1,416.8	+5.3%	1,497.0	+5.7%
EBITDA	644.1	-0.0%	694.1	+7.8%	754.0	+8.6%
EBIT	571.9	+0.8%	614.0	+7.4%	659.9	+7.5%
Pre-tax profit	523.7	-3.4%	561.1	+7.1%	632.5	+12.7%
Post-tax profit	387.0	-22.5%	414.6	+7.1%	452.1	+9.0%
EPS (p)	204.7	-20.5%	219.6	+7.3%	251.9	+14.7%
Dividend (p)	87.9	+12.7%	95.4	+8.6%	109.5	+14.7%
CAPEX	162.0	-20.2%	160.0	-1.2%	151.6	-5.3%
Free cash flow	349.6	+33.5%	396.7	+13.5%	499.3	+25.9%
Net borrowing	1,110.7	-19.3%	1,048.5	-5.6%	969.7	-7.5%

Tristel (LSE:TSTL)

Share price: 265p

Mkt Cap: £118.2bn

EMS: 1500

No of analysts: 1

AIM listed Tristel sells products based on a formulation of chlorine dioxide. Chlorine dioxide is commonly used as a disinfectant, bleaching agent and in applications such as water chlorination. Tristel makes its products at a manufacturing plant in Cambridgeshire.

The company uses its formulation in three main areas:

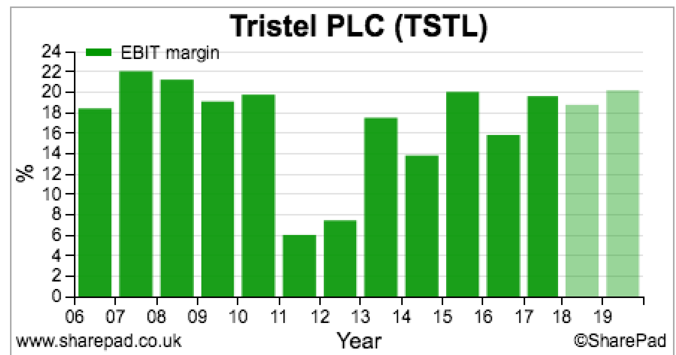
- **Human healthcare (89% of sales)** - products such as wipes and cleaning solutions used as disinfectants in hospitals.
- **Contamination Control (5% of sales)** - products sold under the Crystel brand used as disinfectants in pharmaceutical, personal care and pharmacy markets.
- **Animal Healthcare (6% of sales)** - trading under the Anistel brand selling disinfectants to vets, catteries and kennels.

The company sells a lot of products to the NHS but half the company's sales are now in overseas markets. Its products are designed to stop infections from spreading and are targeted at surgical instruments, surfaces (things like mattresses and bedside tables), water and skin. Around 70% of total sales are for disinfecting medical instruments.

Many of the products come in the form of wipes and disinfect things that can't be treated with heat. It is the only company in its field selling products that are applied by hand. Its competitors' products are based on disinfecting machines.

A quick glance at the financial history of this business suggests that this is a pretty decent business.

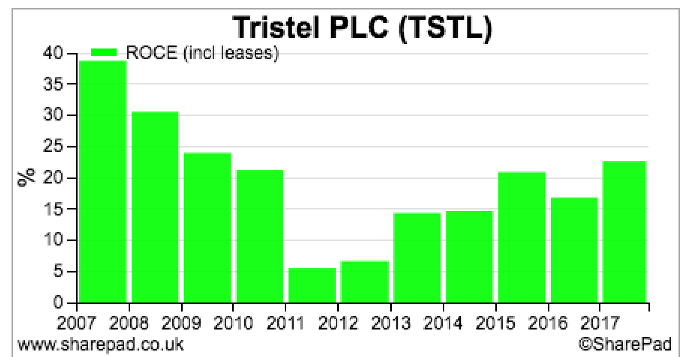
Profit margins are high. Apart from a trough in 2011 and 2012, margins have been consistently high.



The same pattern is true of ROCE.

During the last couple of years, the conversion of profits into free cash flow has been pretty good.

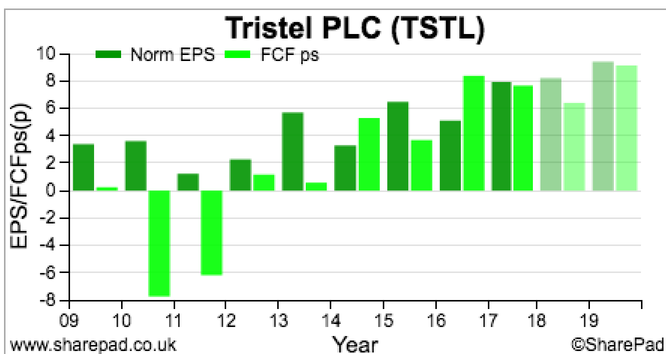
What's so special about selling disinfectant products? Surely it's not difficult to make chlorine dioxide? What has Tristel got that allows it to earn such high profit margins and ROCE? In other words, does this company have an economic moat?



I think it does.

It is the only company using chlorine dioxide to disinfect medical instruments in the world. Its wipes can disinfect small and complex instruments that machines cannot. It has regulatory approvals as a high end disinfectant across many markets as well as a proven track record as a safe and reliable product used across lots of different instruments. This would take a new entrant a lot of time and money to copy.

On top of this it had 229 patents across 35 different markets as of June last year which help to protect its products from competition.



The company has an ambitious plan to grow revenues by 10-15% per year with pre-tax profit margins (before the cost of share based payments) of 17.5% between 2016 and 2019. This week's half year results suggest that the company is well on track to meet its goal. Analysts' forecasts are towards the lower end of that range currently.

Tristel PLC (TSTL)

FORECASTS £ millions unless stated

Year	2018		2019	
Turnover	22.4	+10.5%	25.3	+12.9%
EBITDA	5.5	+5.5%	6.4	+16.4%
EBIT	4.2	+5.7%	5.1	+21.4%
Pre-tax profit	4.2	+4.6%	5.1	+21.4%
Post-tax profit	3.5	+0.9%	4.3	+22.9%
EPS (p)	8.2	+3.5%	9.4	+14.6%
Dividend (p)	4.5	+11.7%	5.0	+11.1%
CAPEX	1.3	+29.5%	1.3	0.0%
Free cash flow	2.8	-16.5%	4.0	+42.9%
Net borrowing	-6.1	+19.9%	-8.3	+36.1%

Growth in the UK healthcare market will be hard to achieve given that the NHS already buys so many products already. Tristel is still hopeful that new products cam still eek out some more growth.

The key growth initiatives are overseas, especially the USA. The company spent £800,000 last year in trying to get regulatory approval to enter the US market and set up a business. To its credit it did not classify these expenses as exceptional to flatter underlying profits. The company is confident of getting its first sales from the USA in 2018/19 but I don't think there is anything material in forecasts by the look of them.

I must admit to quite liking the look of this company. It ticks a lot of boxes in terms of quality and has growth as well. The price tag of its shares is quite high with a rolling forward PE of 30 times but it may well be worth paying up for.

Tristel's share price chart above tells you that this share is hardly undiscovered and has had a good run. If you haven't come across this company before, it might still be worth taking a closer look.

Dunelm (LSE:DNLM)

Share price: 568p

Mkt Cap: £1.15bn

EMS: 1000

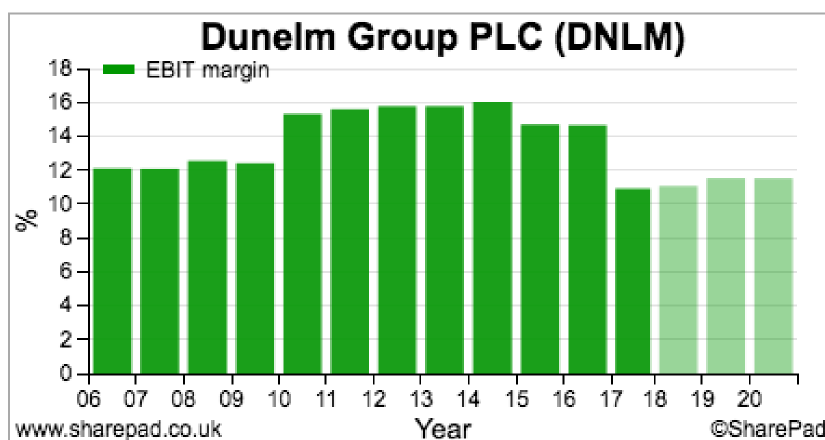
No of analysts: 14

Shares in homewares retailer Dunelm have been going through a rough patch for the last couple of years. It has two key problems in my eyes.

Firstly, its roll out of stores has peaked and is no longer a source of consistent like-for-like sales growth. Secondly, it has been too slow to embrace the internet as a source of sales and its strategy here does not appear to be working very well.

Half year results announced this week actually showed that the stores business has done quite well with LFL sales increasing by a healthy 3.5%. However, this was helped by a weak comparative figure from a year ago when store LFLs fell by 3.1%.

The big problem is profitability from its Worldstores acquisition which lost over £5m during the first half of the year and will lose £7-8m for the year as a whole. This is dragging down pre-tax profits for the group as a whole and means that current forecasts are likely to be lowered over the next week or so.



What I find slightly worrying about Dunelm is that its margins are trending downwards. Some of this can be attributed to changes in sales mix and online losses but the trend is not particularly reassuring. Analysts are currently predicting that they will recover slightly over the next few years.

It is good to see that the store opening schedule has moderated over the last year or so. That said, the 173 stores do have a lot of overheads and cost pressures (especially wages) that require a good chunk of sales growth to make them pay off.

Dunelm Group PLC (DNLM)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	1,074.7	+12.5%	1,141.1	+6.2%	1,211.0	+6.1%
EBITDA	155.6	+15.6%	170.7	+9.7%	181.3	+6.2%
EBIT	118.8	+13.9%	131.4	+10.6%	139.4	+6.1%
Pre-tax profit	118.3	+16.1%	131.7	+11.3%	139.0	+5.6%
Post-tax profit	93.7	+13.4%	104.3	+11.3%	110.4	+5.9%
EPS (p)	46.8	+14.7%	52.0	+11.1%	55.9	+7.5%
Dividend (p)	27.2	+4.6%	29.2	+7.4%	31.0	+6.2%
CAPEX	56.2	-3.1%	48.6	-13.5%	48.6	-0.2%
Free cash flow	73.3	+264.5%	94.3	+28.7%	105.2	+11.5%
Net borrowing	103.2	-15.4%	80.7	-21.8%	18.0	-77.6%
NAV	143.0	+29.9%	185.0	+29.4%	197.0	+6.5%
Like for like sales growth %	3.9		2.5	-35.9%	2.5	0.0%

Profit forecasts look quite optimistic to me and depend to some extent on Worldstores making a profit eventually.

This is not a business that particularly grabs me despite it making a ROCE of 22% last year. Homewares is a brutally competitive market, and whilst Dunelm is a relatively low cost operator. I struggle to see meaningful long-term profitable growth from this business.

The valuation of the shares is not particularly demanding at 11.5 times one year forecast rolling EPS. The forecast dividend yield of 4.8% might tempt some income seekers.

Hotel Chocolat (HOTC)

Share price: 300p

Mkt Cap: £345m

EMS: 1000

No of analysts: 3

Posh chocolate maker and seller Hotel Chocolat is probably one of the most seasonal businesses out there. It makes virtually all of its trading profit at Christmas. Last year its full year trading profit was £11.9m of which £11.7m was made in the first half of the year between July and December. Despite chocolate buying occasions such as Valentines' Day and Easter occurring in the second half of the year, the company operates at around breakeven during that period.

Christmas 2017 looks as if it was a good one for the company. Half year sales increased by a very healthy 15%. Given that 5% came from new stores, it implies a very healthy underlying rate of sales growth of 10%. Online sales increased by 16%. Consequently, full year forecasts look to be in the bag.

Trading profits increased by 13.2% as margins fell due to higher depreciation costs, whilst trading cash flow increased from £22m to £24m.

The company is upbeat about the future and has identified more potential sites for stores and is increasing production capacity by 25%. It is also increasing sales from cafe drinks and wholesaling.

I think Hotel Chocolat is a fairly decent business and is making good returns on capital (c16%). My big query about it is how well it would withstand a recession and a big slump in consumer spending. The natural inclination is to think that it would fare badly, but its reliance on Christmas might just make it more resilient than people think as customers might still see it as an affordable treat. Time will tell.

The company's shares are as expensive as it chocolates and trade on just over 30 times rolling one year forecast EPS. That would be enough to put me off but if current forecasts can be met the shares could hold up quite well.

FORECASTS £ millions unless stated

Year	2018		2019		2020	
Turnover	116.8	+11.0%	128.1	+9.6%	138.7	+8.3%
EBITDA	18.3	+16.1%	20.7	+13.1%	23.0	+11.2%
EBIT	13.6	+12.8%	15.7	+15.6%	17.7	+12.6%
Pre-tax profit	12.9	+14.0%	15.4	+19.4%	17.3	+12.3%
Post-tax profit	10.3	+16.0%	12.2	+18.8%	13.8	+12.7%
EPS (p)	9.0	+13.9%	10.5	+16.7%	12.0	+14.3%
Dividend (p)	2.2	+37.5%	2.6	+18.2%	2.9	+11.5%
CAPEX	8.3	-1.8%	9.3	+12.1%	7.8	-16.2%
Free cash flow	9.1	+240.7%	8.2	-9.4%	11.7	+42.7%
Net borrowing	-9.1	+470.8%	-14.2	+55.8%	-22.2	+56.3%