

Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users



09 March 2018

Market Overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7203.24	▲0.385	▲0.454	▼-1.79	7778.64	7069.9	12/1/18	2/3/18
FTSE 250	19968	▲2.13	▲3.31	▲5.48	20932.6	18832.9	5/1/18	22/3/17
FTSE SmallCap	5758.3	▲0.347	▲1.95	▲7.2	6038.69	5348.3	15/1/18	9/3/17
FTSE AIM 100	5397.15	▲1.32	▲2.6	▲21.8	5550.39	4422.83	29/1/18	9/3/17
FTSE All-Share	3979.76	▲0.67	▲0.977	▼-0.311	4268.89	3899.7	12/1/18	2/3/18
S&P 500	2725.96	▲1.8	▲5.62	▲15.4	2872.87	2328.95	26/1/18	13/4/17
Brent Oil Spot \$	\$63.895	▼-0.475	▼-0.56	▲20.2	\$70.72	\$44.785	24/1/18	21/6/17
Gold Spot \$ per oz	\$1321.10	▲0.302	▼-0.0779	▲9.32	\$1356.22	\$1200.05	24/1/18	9/3/17
GBP/USD - US Dollar per British Pound	1.3821	▲0.331	▼-0.824	▲13.5	1.42661	1.21561	1/2/18	9/3/17
GBP/EUR - Euros per British Pound	1.1219	▼-0.0535	▼-1.29	▼-2.82	1.1972	1.0795	18/4/17	29/8/17

Top FTSE All-Share risers

No.	TIDM	Name	%chg 1w
1	IRV	Interserve PLC	▲41.6
2	SKG	Smurfit Kappa Group PLC	▲28.5
3	SPT	Spirent Communications PLC	▲20.8
4	SRE	Sirius Real Estate Ltd	▲20.4
5	IPF	International Personal Finance...	▲16.6
6	AVV	Aveva Group PLC	▲13.9
7	IBST	Ibstock PLC	▲12.2
8	RR.	Rolls-Royce Group PLC	▲11.3
9	GEMD	Gem Diamonds Ltd	▲11.2
10	DTY	Dignity PLC	▲11.2

Top FTSE All-Share fallers

No.	TIDM	Name	%chg 1w
1	LUCE	Luceco PLC	▼-32.6
2	MTC	Mothercare PLC	▼-20.7
3	HEAD	Headlam Group PLC	▼-16.2
4	MOSB	Moss Bros Group PLC	▼-15.6
5	ALFA	Alfa Financial Software Holdin...	▼-14.4
6	ARW	Arrow Global Group PLC	▼-13
7	JE.	Just Eat PLC	▼-11.2
8	BIFF	Biffa PLC	▼-10.6
9	TYMN	Tyman PLC	▼-10.3
10	UPGS	UP Global Sourcing Holdings ...	▼-9.82

Ibstock (LSE:IBST)



Share price: 298p

Mkt Cap: £1.2bn

EMS: 2,000

No of analysts: 11

The UK market for newly built homes is in a very healthy state. This is evidenced by the rapid growth in the profits of the quoted house builders who have been building more houses and selling them for rising prices.

New houses need bricks. At the moment, there is a shortage of bricks in the UK housing market which uses around 2.4 billion bricks a year at current build rates. Last year, UK brick makers made and sold around 1.9 billion with the 0.5 billion difference being made up from imports and the running down of existing stockpiles.

This kind of backdrop looks very favourable for Ibstock, the UK's biggest seller of clay bricks by volume. It is also a leading player in making and selling concrete products such as fence posts, gravel boards, walls and roof tiles. The company also had a brick business in the north east and mid- west United States.

2017 was a decent year for Ibstock's UK business. Brick sales were up by 4.6% with concrete sales up by a healthy 7.4%. However, it seems that sales could have been much stronger had it had enough capacity to produce more.

The company's brick ovens were kept very busy during the year as demand from builders continued to increase. Production was ramped up to maximum levels but by last summer many customers were having to wait for bricks and roof tiles. This clearly held back Ibstock's sales and profits last year.

High utilisation of its manufacturing sites and strong demand fed through to a £19m increase in revenue and £8m increase in EBITDA. EBITDA margins increased from 29.8% to 30.5%.

United Kingdom

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Revenue	363	344
Adjusted EBITDA	111	103
Adjusted EBITDA margin	30.5%	29.8%

The US business is nowhere near as profitable as the UK and has much lower profit margins. It is not performing that well with sales and profits falling last year. The lower margins are explained by much lower capacity utilisation which means that revenues do not cover fixed costs by as much as they do in the UK.

United States

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Revenue	89	91
Adjusted EBITDA	12	13
Adjusted EBITDA margin	13.1%	13.8%

Low capacity utilisation across the industry means that companies fight harder for orders and market share. It seems that Ibstock has been losing out. By refusing to cut its selling prices it has lost some market share.

I think that the company is flagging up the possibility that it might consider selling the US business given the following comment in its results release:

“In the US, the brick industry continues to operate at low levels of capacity utilisation resulting in lower returns than we enjoy in the UK. Against this backdrop, we continue to consider all options and opportunities for our business.”

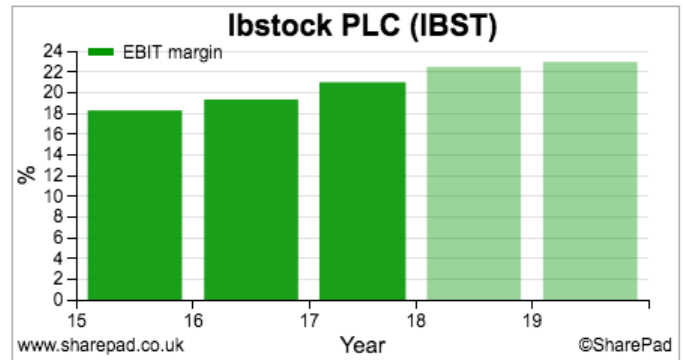
A sale looks like a good idea to me as Ibstock’s US business adds little in profits and dilutes the quality of the UK operations. The cash raised from any sale could be used to pay down debts or pay special dividends.

At the moment, Ibstock is in something of a sweet spot. Whilst housebuilding and brick making are cyclical the cycle is still in an upswing. On top of this, it operates in an industry with very high barriers to entry. 90% of the UK brick industry production is in the hands of just three companies. You need large reserves of clay and nearby manufacturing facilities to have a viable business in this industry and that’s not something that can be copied.

What this means is that when times are good and capacity utilisation of brick making plants are high, a company such as Ibstock can be very profitable indeed. Profit margins can exceed 20%.

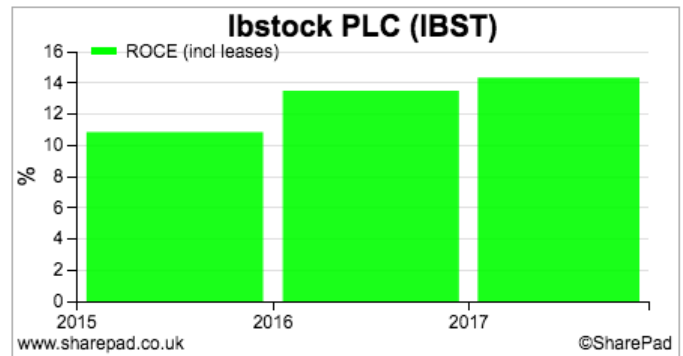
Return on capital employed is also currently at fairly reasonable levels.

However, when the housing market turns down, capacity utilisation falls and companies can be left with large stocks of unsold bricks and roof tiles. This can see levels of profitability, margins and ROCE collapse.



The good news for Ibstock shareholders is that the sun is still very much shining. Demand from builders remains strong which means that its new brick factory in Leicestershire is being commissioned at a very good time.

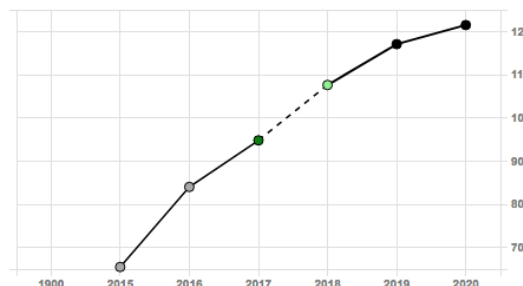
The new facility will add an extra 50 million of brick capacity this year and another 50 million in 2019. This should allow Ibstock to take market share from imported brick sales and should boost UK brick margins by 1-2% in 2018 with a further uplift in 2019.



This all paints a very rosy outlook for profits over the next few years as long as builders keep building at current levels. The other positive development is that capex is expected to decline significantly now that the new brick factory has been built. This in turn should lead to a big improvement in free cash flow and reduction in net borrowing levels.

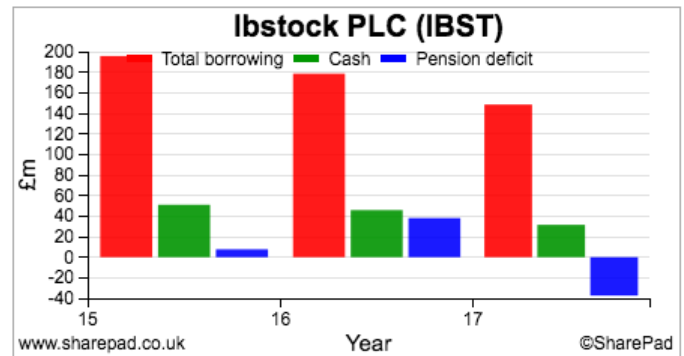
Ibstock PLC (IBST)						
FORECASTS						
£ millions unless stated						
Year	2018	2019	2020			
Turnover	478.9	+6.0%	510.2	+6.5%	526.8	+3.3%
EBITDA	128.6	+6.1%	141.0	+9.7%	145.5	+3.2%
EBIT	107.6	+13.5%	117.1	+8.8%	121.5	+3.8%
Pre-tax profit	107.2	+31.4%	115.3	+7.6%	116.9	+1.4%
Post-tax profit	84.0	+24.3%	92.8	+10.4%	94.7	+2.1%
EPS (p)	21.1	+27.5%	22.8	+8.1%	23.3	+2.2%
Dividend (p)	10.2	+12.1%	11.4	+11.8%	14.1	+23.7%
CAPEX	15.4	-59.4%	14.7	-4.5%	13.0	-11.7%
Free cash flow	79.2	+41.7%	88.8	+12.2%	-	-
Net borrowing	94.4	-19.4%	33.3	-64.8%	19.1	-42.5%
NAV	459.2	+9.1%	497.4	+8.3%	-	-
Like for like sales growth %	-	-	-	-	-	-

EBIT £



Given this positive outlook and the fact that the final salary pension scheme is now in surplus, it is not that surprising that the company has announced its intention to pay extra dividends on top of its regular payments. The first additional dividend will be announced in August.

Cyclical businesses always carry a larger amount of risks for investors as falling profits tend to lead to falling share prices and sometimes dividend cuts. This means that Ibstock shares are probably not long-term buy and hold investments.



That said, given the state of the house building cycle in the UK, I'd probably rather own shares in a brick maker than a house builder right now. Builders' profits have been juiced up by Help to Buy boosting selling prices and I don't think that trend can continue for much longer.

Demand for bricks is another matter. A housing shortage and a government looking to increase the building of more affordable houses should be very supportive for the likes of Ibstock.

The shares trade on a one year forecast rolling PE of just over 13 times with a prospective dividend yield of 3.6% before special dividends are taken into account. That's not screamingly cheap but not too unreasonable for a business with a decent profit growth expected for the next couple of years.

Lookers (LSE:LOOK)



Share price: 95p

Mkt Cap: £367bn

EMS: 3,000

No of analysts: 9

Car dealership businesses have been doing very well in recent years due to a boom in credit driven (personal contract plans or PCPs) new car sales. Times are now a lot tougher as the UK car market is cooling off having reached record levels of sales. UK new car sales fell in 2017 by 5.6% and are expected to fall by a similar level again in 2018.

Given this backdrop, Lookers' full year results for 2017 are reasonably good. New car sales increased by 3% on a like-for-like (LFL) basis but used car sales grew much faster at 13% on a LFL basis. Aftersales - servicing and repairs - which is the company's biggest source of gross profit saw LFL sales grow by 4%. This helped adjusted pre-tax profit increase by 5% to 68.4m.

However, as is often the case, a study of a company's cash flow statement throws up more insights into to what's going on within a business.

Consolidated Cash Flow Statement

For the year ended 31 December 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Profit for the year		47.9	81.3
Adjustments for:			
Tax		10.5	10.5
Depreciation		20.7	21.5
Dividend received		-	-
Fair value on derivative instruments		(2.4)	-
Loss on disposal of plant and equipment		0.4	-
Profit on disposal of rental fleet vehicles		-	(0.2)
Profit on disposal of business		-	(28.0)
Amortisation of intangible assets		5.6	1.7
Share based payments		1.7	1.8
Interest income		(0.3)	-
Interest payable		16.6	17.6
Debt issue costs		0.4	0.4
Impairment of goodwill		-	1.0
Changes in working capital			
Increase in inventories		(144.7)	(23.4)
Decrease/(Increase) in receivables		(16.1)	27.6
Increase in payables		143.0	93.2
Impact of net working capital from discontinued business		-	(70.2)
Impact of net working capital of acquisitions		-	6.1
Cash generated from / (used by) operations		83.3	140.9
Difference between pension charge and cash contributions		(7.8)	(7.1)
Net interest and costs on pension scheme obligation		4.2	3.7
Purchase of rental fleet vehicles		(87.1)	(93.7)
Proceeds from sale of rental fleet vehicles		87.0	87.4
Interest paid	2	(16.6)	(17.6)
Interest received	2	0.3	-
Tax paid		(25.5)	(14.2)
Net cash inflow from operating activities		37.8	99.4

Operating cash flow is down significantly. The huge increase in inventories (stocks of cars) is a potential red flag. Car dealerships have lots of stocks of cars and need to turn these into cash as quickly as possible. Cars that stay on the forecourt too long not only tend to incur financing expenses but are at increased risk of losing value and damaging profitability.

The company does provide an explanation for the stock increase:

“Cash generated from operations for the year continued to be strong at £83.3 million, but this was a reduction compared to the prior year (2016: £140.9 million) as stock levels were higher due to buying stock in December to take advantage of lower market prices with a view to having an above average trading result for January.”

There has been no comment as to whether sales were as good as expected in January in the outlook statement. If they were, then profit margins may have benefited given the reference to lower market prices for stock. If they were not, then profits may take a hit if prices have to be cut to shift this stock.

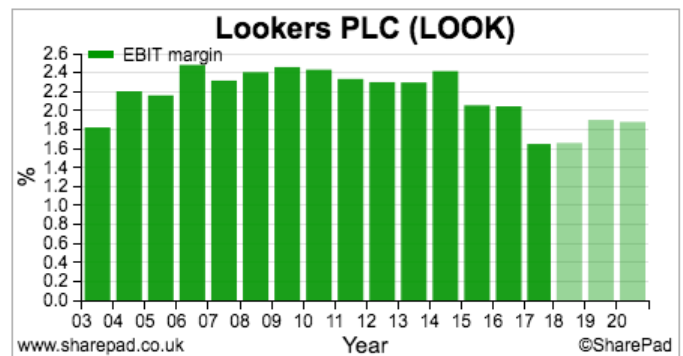
We can also see that Lookers offset the cash outflow from the stock build with a significant increase in payables - presumably by extending credit payment periods with its suppliers. This is the second year in succession that the company has seen a significant cash inflow from payables. It can't keep doing this every year.

There is also a cash outflow from increased debtors.

Profit margins remain wafer thin and fell from 2% to 1.8% last year. I'm not a fan of low margin businesses as they offer little protection if trading turns down.

Low margins also mean that a business is very dependent on a high volume of sales to make meaningful amounts of money. The other way is to shift sales towards higher margin products or services.

Going forward, Lookers is putting more emphasis on making money from selling used cars and aftersales where profit margins are higher. Profits from servicing should hold up reasonably well as most cars on PCP agreements have to be serviced through main dealer networks. The growth in new car registrations financed by PCPs in recent years should see a steady flow of customers for the next couple of years.



Used car sales are likely to be solid as well in my opinion, particularly if consumers switch away from buying new cars. The key issue here is how well Lookers manages its stock levels and cash flow. As far as new car sales are concerned, the company is looking to win more fleet business and is sensibly staying clear of low margin contracts.

Lookers has also been tied into fixed rate borrowings at much higher interest rates than are currently available. These financing agreements are slowly unwinding and may provide a small boost to pre-tax profits from lower interest costs.

Lookers PLC (LOOK)						
FORECASTS			£ millions unless stated			
Year	2018		2019		2020	
Turnover	4,550.6	-3.1%	4,700.0	+3.3%	4,772.5	+1.5%
EBITDA	98.5	-5.0%	110.8	+12.4%	116.3	+5.0%
EBIT	75.5	-2.5%	89.4	+18.4%	89.7	+0.4%
Pre-tax profit	65.4	+11.2%	73.4	+12.2%	75.8	+3.3%
Post-tax profit	59.3	+22.9%	60.0	+1.1%	58.6	-2.4%
EPS (p)	13.0	+10.2%	14.8	+13.8%	15.3	+3.4%
Dividend (p)	4.1	+5.4%	4.1	0.0%	4.4	+7.3%
CAPEX	35.8	-35.5%	30.3	-15.5%	38.0	+25.6%
Free cash flow	49.9		52.3	+4.9%	-	
Net borrowing	68.8	-29.7%	20.9	-69.7%	29.6	+41.7%

Lookers' shares are not expensive by any means and trade on a one year forecast rolling PE of 7 times and a yield of 4.4%. Whilst profits growth may be hard to achieve, the company has announced that it intends to spend £10m on buying back shares.

Bear in mind that the benefits of share buybacks can be a little unclear sometimes. In many cases they work to offset the dilution caused by the issue of new shares from things such as share options. Interestingly, the number of dilutive shares has increased from 9.5m to 12m over the last year but they remain a lower proportion of the 397m total shares in issue.

The valuation of the company does have some asset backing. The net book value of freehold property associated with dealership properties is £308m compared with the current market capitalisation of £367m. What we don't know is the alternative use potential of those dealership properties and therefore how conservative the balance sheet value is.

Abcam (LSE:ABC)



Share price: 1214p

Mkt Cap: £2.4bn

EMS: 2,000

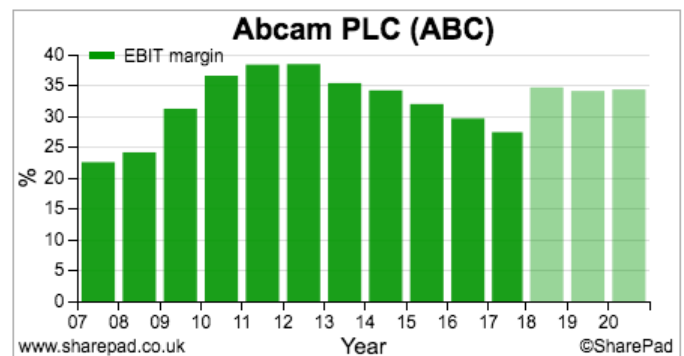
No of analysts: 8

Abcam is a leading maker and seller of research antibodies to scientists across the world. Its products aim to make life easier for its customers by allowing them to understand the causes of diseases and thus develop new treatments for them.

The company makes the bulk of its money by selling from a catalogue of its antibodies. It also sells licenses to companies so that they can use its antibodies in diagnostic and therapeutic applications.

Abcam is trying to maintain its growth in sales and profits by developing new products and entering new markets. It is also putting a lot of effort into the digital marketing of its products to drive sales.

If you want to read a bit more about the company's strategy then check out [Richard Beddard's recent analysis of the company here](#).



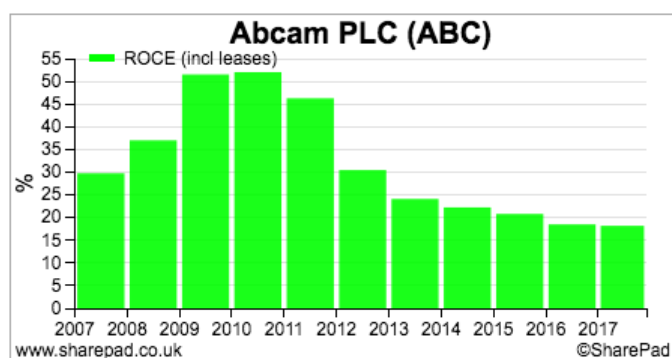
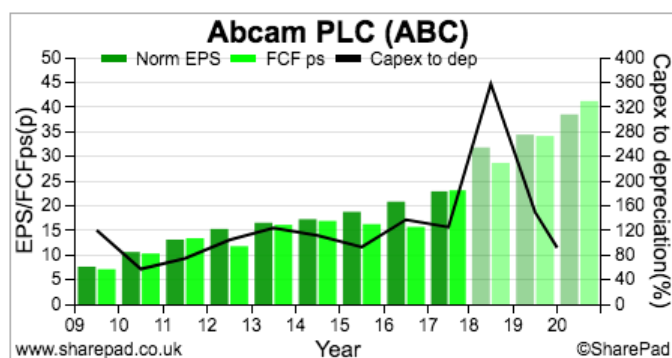
Abcam shares have proven to be an excellent long term investment. It has been able to grow whilst generating very high levels of profitability.

It is worth noting that profit margins and ROCE are not as high as they used to be but they are still at levels that many companies can only dream of.

The company's ability to turn its profits into free cash flow has also been very good - another hallmark of quality.

The key issue that many investors will wrestle with is the high valuation of the shares - 35 times forecast rolling EPS - and whether the company can grow fast enough to justify it.

This week's half year results are reasonably reassuring on this issue. Constant currency revenue growth from its Catalogue business of 11.5% is a very good performance with particularly strong growth coming from China.



	Reported revenue		Increase / (Decrease) in reported revenue	Constant currency growth rate
	H1 2018 £'m	H1 2017 £'m		
Geographic split				
The Americas	42.5	40.0	6.3%	8.2%
EMEA	29.9	26.8	11.6%	9.7%
China	16.5	13.5	22.2%	24.5%
Japan	7.9	8.0	(1.3%)	8.5%
Rest of Asia Pacific	8.4	7.3	15.1%	15.1%
Catalogue revenue	105.2	95.6	10.0%	11.5%
CP&L revenue*	7.3	6.9	5.8%	7.8%
Total reported revenue	112.5	102.5	9.8%	11.2%
Catalogue product split				
Primary and secondary antibodies	85.2	78.7	8.3%	9.6%
o/w Recombinant primary antibodies	22.4	18.5	21.1%	22.8%
Other products**	20.0	16.9	18.3%	20.1%
o/w Immunoassay products	7.0	5.8	20.7%	23.4%
Catalogue revenue	105.2	95.6	10.0%	11.5%

*Includes royalty income, custom products and licensing revenue

** Includes kits and assays, proteins, peptides, lysates and AAI products

Profits growth was good too with profit margins improving. Adjusted diluted EPS increased by 20.2%.

Notes to the interim financial information (continued)

For the six-month period ended 31 December 2017

4. Consolidated adjusted financial measures

The calculation of the Group's key adjusted measures is presented below:

	Note	(Unaudited) six months ended 31 Dec 2017			(Unaudited) six months ended 31 Dec 2016		
		Adjusted £m	Adjusting items £m	Total £m	Adjusted £m	Adjusting items £m	Total £m
EBITDA¹		42.7	(3.7)	39.0	35.9	(0.4)	35.5
Margin%		38.0%		34.7%	35.1%		34.5%
Depreciation and amortisation		(3.5)	(2.8)	(6.3)	(3.9)	(3.3)	(7.2)
Operating profit		39.2	(6.5)	32.7	32.0	(3.7)	28.3
Margin%		34.8%		29.1%	31.2%		27.6%
Finance income		0.1	—	0.1	0.1	—	0.1
Finance costs		—	—	—	—	(3.3)	(3.3)
Profit before tax		39.3	(6.5)	32.8	32.1	(7.0)	25.1
Margin%		34.9%		29.2%	31.4%		24.5%
Tax	5	(7.4)	6.9	(0.5)	(5.9)	0.6	(5.3)
Profit for the period attributable to owners of the parent		31.9	0.4	32.3	26.2	(6.4)	19.8

¹ EBITDA = Earnings before interest, tax, depreciation and amortisation

2018 is expected to be a very strong year with growth then expected to moderate according to current consensus forecasts.

Abcam PLC (ABC)

FORECASTS

£ millions unless stated

Year	2018		2019		2020	
Turnover	235.9	+8.6%	260.8	+10.6%	285.0	+9.3%
EBITDA	90.8	+21.3%	102.9	+13.3%	113.8	+10.6%
EBIT	81.8	+37.4%	89.0	+8.7%	97.9	+10.1%
Pre-tax profit	81.2	+44.3%	88.4	+8.8%	98.6	+11.6%
Post-tax profit	65.2	+39.3%	72.0	+10.5%	80.2	+11.4%
EPS (p)	31.8	+38.9%	34.4	+8.2%	38.5	+11.9%
Dividend (p)	12.4	+21.8%	13.9	+12.1%	14.7	+5.8%
CAPEX	32.2	+68.0%	20.8	-35.4%	14.6	-30.0%
Free cash flow	58.6	+24.0%	69.7	+19.0%	84.2	+20.8%
Net borrowing	-94.3	+11.3%	-131.7	+39.6%	-182.3	+38.3%
NAV	342.6	+11.6%	390.2	+13.9%	433.5	+11.1%

Looking at the numbers, it is clear that Abcam is a very high quality business with a good strategy. I find these kinds of businesses quite difficult to understand and have problems working out what will happen to the science and competition in the future. This is a reflection of my own deficiencies and not a criticism of the company. I can see why many investors are happy to own shares in Abcam even though the valuation is high.