

## Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users



26 April 2018

This week's round up is a little shorter than usual as I am presenting at the Mello investing conference in Derby. I hope to meet some of you there.

### boohoo.com (LSE:BOO)



Boohoo.com (boohoo) is without doubt one of the best businesses that you will come across on AIM. The company has been incredibly successful at capturing a growing share of the young fashion market (16-30-year olds). It has done this by selling lots of attractive clothing items at very attractive prices and backed this up with good service levels and innovative branding. In short, it is a very well-run business.

Rapid rates of sales and profits growth have seen the company's share price literally go through the roof. Around 18 months ago its shares were trading at a valuation of over 100 times trailing earnings (EPS) as a prolonged series of profit forecast upgrades saw them become a classic momentum trade.

Since then, the lack of further forecast upgrades has seen the share price fall back significantly. In the meantime, the company has continued to grow strongly and profitably – just not by more than people expected. There has also been some concern on whether the company could maintain its profit margins whilst continuing to grow sales at a fast rate.

Wednesday's full year results for the year to February 2018 will have calmed the nerves of any unsettled shareholders, as the company released a very reassuring set of numbers and outlook statement.

From a trading perspective, the company continues to perform very well. Its two established brands of boohoo and Pretty Little Thing (PLT) have more customers, more orders and bigger order sizes that are feeding through into impressive rates of sales growth. Nasty Gal, its new brand has got off to a decent start. For the group as a whole, sales and profits came in a little bit ahead of analysts' forecasts.

<b>boohoo.com (£m)</b>	<b>2018</b>	<b>2017</b>
Revenues	579.8	294.6
Operating profit	42.685	30.308
Amortisation of acquired intangibles	4.449	0.434
Gain on option PLT		-1.405
<b>Adjusted operating profit</b>	<b>47.134</b>	<b>29.337</b>
<b>Operating margin</b>	<b>8.13%</b>	<b>9.96%</b>

Profit margins have taken quite a big hit and are down 183 basis points year on year. This is largely due to the 330 basis points reduction in gross margins at the boohoo brand as a result of cutting prices. This was offset by distribution efficiencies which were a lower percentage of revenues.

My figures for adjusted operating profit treat share-based payments (£3.27m in 2018) as a cost of doing business whereas boohoo's definition of adjusted profits does not. This is a growing trend amongst companies which I do not agree with. Just because they are a non-cash item does not mean that there has not been an economic transfer of value away from the owners of the business. They are a real cost and saying they are not reflects badly on management teams in my opinion.

boohoo's cash flow performance was much improved. Free cash flow generated was £23.1m compared with an outflow of £0.57m last year. Most of this improvement came from a big increase in trade and other payables of £38.8m which was offset slightly by higher capex on the company's new automated warehouse.

**Consolidated cash flow statement**  
for the year ended 28 February 2018

	Note	2018 £000	2017 £000
<b>Cash flows from operating activities</b>			
Profit for the year		36,000	24,661
<i>Adjustments for:</i>			
Share-based payments charge		3,269	1,895
Depreciation charges and amortisation		10,978	4,765
Gain on option to acquire PrettyLittleThing.com Limited		-	(1,405)
Finance income		(774)	(637)
Finance expense		146	-
Tax expense		7,313	6,284
		<b>56,932</b>	<b>35,563</b>
Increase in inventories	14	(14,078)	(11,925)
Increase in trade and other receivables	15	(5,393)	(4,107)
Increase in trade and other payables	16	38,780	15,166
Cash generated from operations		76,241	34,697
Tax paid		(7,227)	(5,206)
<b>Net cash generated from operating activities</b>		<b>69,014</b>	<b>29,491</b>

Stock control was good considering the rate of sales growth. Profits were reduced by a £3.4m impairment provision in stocks (compared with £0.29m last year) but this is nothing to worry about in my opinion. That said, the hit to operating profits was reasonably significant.

The company ended the year with net cash balances of £133m. This gives it plenty of capacity to invest in new warehousing capacity in the future to meet its aspiration of £3bn of annual sales. It should not have to ask shareholders for more money to do this in my opinion.

Despite investing heavily in new warehousing assets, boohoo's ROCE remains impressive at 27.6% (29.5% on a lease-adjusted basis last year but capitalised leases are not significant in this business). Its capital turnover ratio of £3.40 of revenues per £1 of average capital employed is also very good.

<b>boohoo.com (£m)</b>	<b>2018</b>	<b>2017</b>
Revenues (A)	579.8	294.6
Adjusted operating profit (B)	47.134	29.337
Total Assets	326.887	189.123
less current liabilities	-104.394	-74.425
add back s-term debt	2.382	2.382
Capital Employed (C)	224.875	117.08
Average Capital Employed (D)	170.9775	
<b>ROCE = B/D</b>	<b>27.6%</b>	
Capital Turnover (x) = A/D	3.4	

Boohoo is in a very good place. The current year's trading has started well according to the company and it has reassured investors on the outlook for profit margins:

"Trading in the first few weeks of the 2019 financial year has made a strong start. Group revenue growth for the next financial year (FY19) is expected to be 35% to 40% with adjusted EBITDA margin between 9% to 10% and capital expenditure of £50 to £60 million."

<b>boohoo.com PLC (BOO)</b>						
<b>FORECASTS</b>						
£ millions unless stated						
Year	2018		2019		2020	
Turnover	574.9	+95.1%	792.7	+37.9%	1,073.6	+35.4%
EBITDA	53.3	+52.9%	69.7	+30.8%	92.2	+32.3%
EBIT	41.5	+37.9%	52.4	+26.1%	72.2	+37.9%
Pre-tax profit	43.7	+41.3%	53.5	+22.3%	73.2	+36.9%
Post-tax profit	33.5	+36.9%	38.9	+16.3%	47.1	+21.0%
EPS (p)	2.8	+29.6%	3.4	+21.4%	4.3	+26.5%
Dividend (p)	-		-		-	
CAPEX	63.0	+105.5%	106.2	+68.5%	80.2	-24.5%
Free cash flow	-16.4		-43.6		25.8	
Net borrowing	-92.0		-49.2		-56.5	
NAV	187.0	+93.7%	228.5	+22.2%	292.0	+27.8%

This suggests that consensus EBITDA and profit forecasts could move up slightly. Capex forecasts are way too high as well and will come down. This will lead to higher free cash flow forecasts.

The company hopes that increased automation in its warehousing will allow it to earn long-term EBITDA margins of 10%:

"Looking beyond the current year we will continue to lead the market on value, service and proposition in all our key geographies. Whilst this will require a continued investment in people and infrastructure, we believe that the benefits of our investments in marketing and warehouse automation will generate economies of scale to allow us to drive sales growth of at least 25%, whilst maintaining a 10% EBITDA margin."

These reassuring comments have seen a sharp rally in the share price as a key concern seems to have been addressed. There's clearly a lot to like about this business but I still think gross margins need to be watched. Getting the business to perform as well internationally as it does in the UK is also a key challenge.

At 176p, the shares trade on a 2019 forecast PE of 51.8 times. This will come down if forecast upgrades come through. This valuation will continue to put off value investors but those with a long-term perspective could continue to prosper if this business becomes as big as boohoo wants to be at current profit margins.

## Lok n' Store (LSE:LOK)



Lok n' Store (Lok) has been opening up lots of self-storage sites, mainly in the south of England. I first looked at this business back in November and quite liked it as I think the fundamentals supporting demand for its services were promising – namely an undersupply of facilities in the UK due to high land prices. I did, however, question the company's estimate of NAV per share as it ignored the deferred tax on valuation gains.

In the meantime, the company's share price has not made much progress. This week's half year results show reasonable income growth at the self-storage business with like-for-like revenues up 6.9%. This was driven mainly by an increase in occupancy from 60% to 66% with unit pricing up by 0.4%.

High fixed costs and good cost control saw all of the £476,000 increase in revenue flow through to a 24% increase in operating profit. The company remains very lightly geared with a loan to value ratio of just 16.8%. The interim dividend was increased by 11% to 3.33p per share.

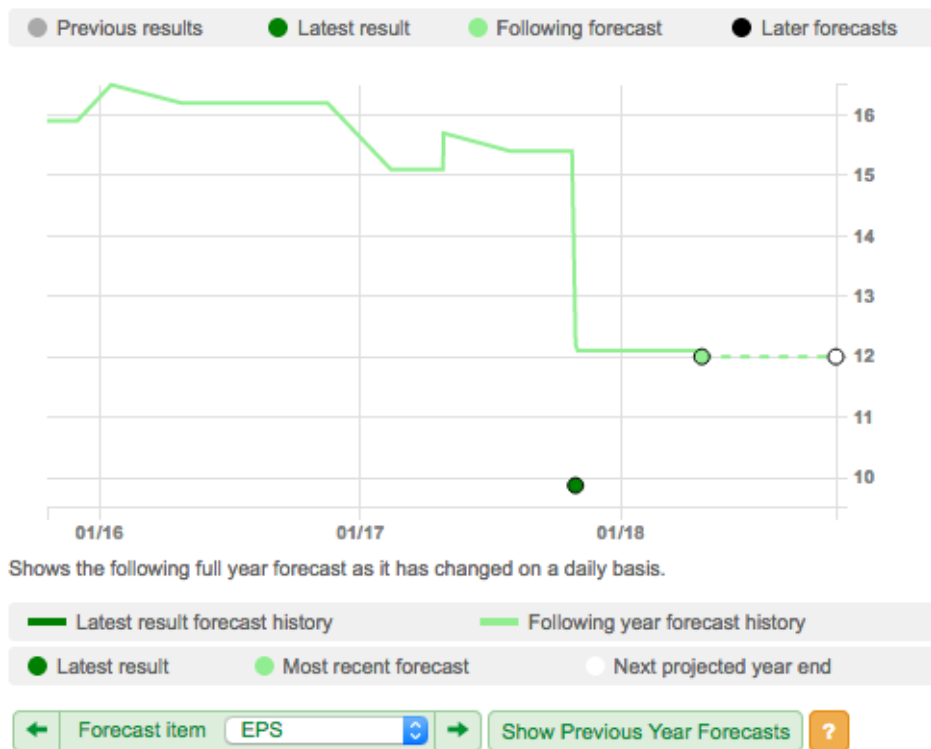
There has been little progress in the asset valuation of the business. Balance sheet NAV per share was broadly unchanged over the last six months at 352p per share with adjusted NAV per share – ignoring deferred tax on gains – also broadly unchanged at 418p.

<b>Analysis of net asset value (NAV)</b>	<b>31 Jan 2018 £'000 Unaudited</b>	<b>31 Jan 2017 £'000 Unaudited</b>	<b>31 July 2017 £'000 Audited</b>
Net assets	89,775	80,733	89,119
Adjustment to include operating/short leasehold stores at valuation			
Add: JLL leasehold valuation	16,725	16,575	16,725
Deduct: leasehold properties and their fixtures and fittings at NBV	(2,777)	(3,006)	(2,878)
	<b>103,723</b>	94,302	102,966
Deferred tax arising on revaluation of leasehold properties <sup>1</sup>	(2,371)	(2,307)	(2,354)
Adjusted net assets	<b>101,350</b>	91,995	100,612
	<b>Number</b>	<b>Number</b>	<b>Number</b>
Shares in issue	<b>'000</b>	<b>'000</b>	<b>'000</b>
Opening shares in issue	29,303	29,109	29,109
Shares issued for the exercise of options	127	90	194
Closing shares in issue	29,430	29,199	29,303
Shares held in treasury	-	(492)	-
Shares held in EBT	(623)	(623)	(623)
Closing shares for NAV purposes	<b>28,807</b>	28,084	28,680
Adjusted net asset value per share after deferred tax provision	<b>£3.52</b>	£3.28	£3.51
<b>Adjusted net asset value per share before deferred tax provision</b>			
Adjusted net assets	101,350	91,995	100,612
Deferred tax liabilities and assets recognised by the Group	16,633	14,446	16,363
Deferred tax arising on revaluation of leasehold properties <sup>1</sup>	2,371	2,307	2,354
Adjusted net assets before deferred tax	<b>120,354</b>	108,748	119,329
Closing shares for NAV purposes	<b>28,807</b>	28,084	28,680
Adjusted net asset value per share before deferred tax provision	<b>£4.18</b>	£3.87	£4.16

The company's new sites are performing well and with 11 further sites in the pipeline the company looks to be in a good position to keep on growing its profits and dividends for shareholders.

<b>Lok'nStore Group PLC (LOK)</b>						
<b>FORECASTS</b>			<b>£ millions unless stated</b>			
<b>Year</b>	<b>2018</b>	<b>2019</b>	<b>2019</b>	<b>2020</b>	<b>2020</b>	<b>2020</b>
Turnover	17.7	+6.3%	19.1	+7.9%	20.7	+8.4%
EBITDA	7.3	+15.4%	8.2	+12.3%	9.3	+13.4%
EBIT	5.1	+18.4%	5.7	+11.8%	6.5	+14.0%
Pre-tax profit	4.5	+12.2%	4.9	+8.9%	5.6	+14.3%
Post-tax profit	3.6	+26.8%	3.9	+8.3%	4.5	+15.4%
EPS (p)	12.0	+21.6%	13.2	+10.0%	15.3	+15.9%
Dividend (p)	11.0	+10.0%	12.0	+9.1%	13.2	+10.0%

I sense that the shares have struggled in recent months because the pace of expansion of new sites is not as fast as previously expected. As you can see from the chart below, consensus EPS forecasts for 2018 have come down quite sharply since the end of 2017.



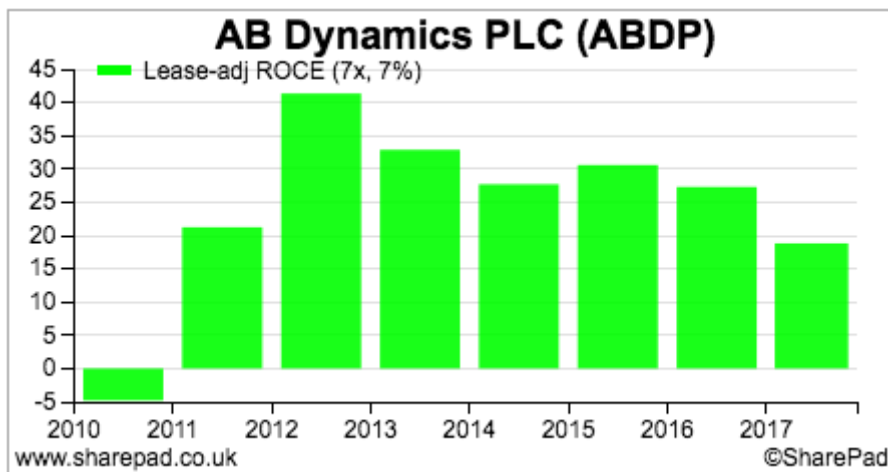
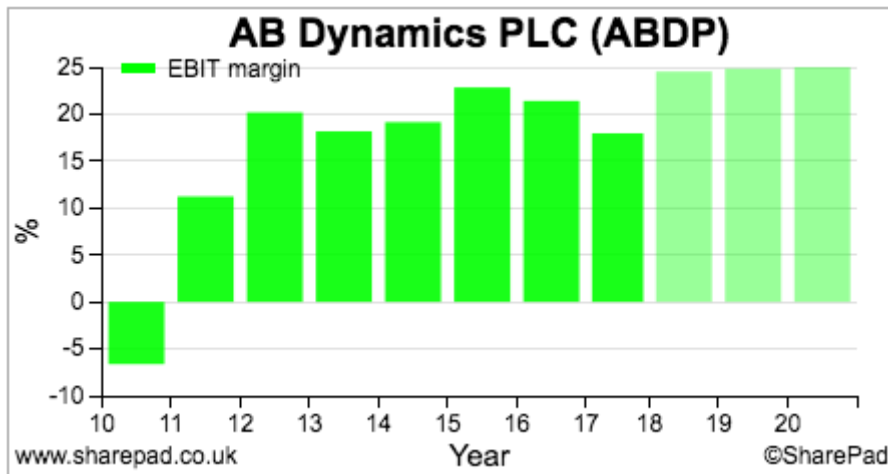
The other concern is that it will become more difficult for the company to benefit from upwards asset revaluations if interest rates rise.

At 398p, the shares trade below the company's adjusted NAV per share figure but at a premium to the balance sheet NAV per share. This doesn't suggest that the shares are particularly cheap. The prospective dividend yield of 2.8% is nothing to write home about either but is compensated somewhat by expectations of 10% dividend growth. That said, I think these shares could tread water for some time.

AB Dynamics (LSE:ADBP)



AB Dynamics designs, manufactures and supplies advanced testing systems and measurement products for the global automotive industry. The company has many of the hallmarks of a quality business with high profit margins and a high return on capital employed (ROCE).





Its shares have been on a storming run since the end of 2015 before having a major wobble at the beginning of 2018 for no apparent reason.

All seems well again now as the company delivered a very impressive set of half year results. Sales were up 39% as the company is seeing very good demand for its products. Going forward, there seems to be a strong growth opportunity in driverless car technology, providing they are proven to be safe and reliable of course.

The company has a strong order book and has set up a new business in Germany to support the markets there. The order book is already full enough to give strong visibility for 2018's sales and into 2019. This should mean that the company should be able to hit analysts' forecasts for 2018.

As far as its financial performance goes, everything looks very healthy. Operating margins increased from 14.6% to 19.1% due to lower share-based payments (ABDP is another company that thinks they should be ignored by investors despite them being very significant costs at the company).

The highlight was probably the very strong operating cash flow performance. Due to a vastly improved working capital position, operating cash flow for the half year was more than double generated in the whole of 2017.

	Unaudited 6 months Ended 28 February 2018 £	Unaudited 6 months Ended 28 February 2017 £	Audited Year Ended 31 August 2017 £
<b>Cash flow from operating activities</b>			
Profit before taxation	2,936,672	1,651,757	4,472,027
Adjustments for: -			
Change in accounting policy	-	-	(78,562)
Depreciation of property, plant and equipment	214,245	125,533	266,856
Loss on sale of property, plant and equipment	6,750	4,242	4,243
Finance income and costs	-	(32,270)	-
Interest income	(18,977)	(43,010)	(65,257)
Share based payment	366,204	805,649	1,464,817
<b>Operating cash flows, before working capital changes</b>	<b>3,504,894</b>	<b>2,511,901</b>	<b>6,064,124</b>
Decrease/(increase) in inventories	(1,919,095)	(588,804)	(1,767,793)
Decrease/(increase) in trade and other receivables	1,448,578	(718,061)	(5,432,557)
(Decrease)/increase in other payables	2,509,819	247,710	3,342,941
Fair value loss/(gain) on derivative instruments	-	-	(90,434)
<b>Cash flow (used in) / from operations</b>	<b>5,544,196</b>	<b>1,452,746</b>	<b>2,116,281</b>

I think AB Dynamics is a very good business. However, I must confess that I don't quite understand the long-term stability of its profits and cash flows. Clearly, the company is in a good position right now, but the automotive industry is cyclical and I personally do not have enough confidence to know whether profits can go higher but stay higher as well.

**AB Dynamics PLC (ABDP)****FORECASTS**

£ millions unless stated

Year	2018	2019	2020
Turnover	31.9	37.9	44.6
EBITDA	8.3	10.0	11.8
EBIT	7.8	9.4	11.1
Pre-tax profit	7.9	9.5	11.3
Post-tax profit	7.2	8.6	10.2
EPS (p)	34.8	40.6	48.2
Dividend (p)	3.7	4.0	4.4
CAPEX	3.3	3.3	3.3
Free cash flow	3.1	4.5	6.4
Net borrowing	-12.8	-16.4	-20.4

At 994p, the shares trade on a rolling one year forecast PE of just over 26 times which suggests to me that the rosy outlook for the next few years has been priced in.