Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

17 May 2018

Market Overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7787.97	▲1.13	▲7.78	▲3.79	7787.97	6888.69	17/5/18	26/3/18
FTSE 250	21019.4	▲1.55	▲6	▲6.3	21019.4	19187.1	17/5/18	26/3/18
FTSE SmallCap	6015.76	▲0.838	▲4.96	▲7.03	6038.69	5551.56	15/1/18	4/4/18
FTSE AIM 100	5656.22	▲0.711	▲6.03	▲16.8	5667.51	4768.33	16/5/18	6/7/17
FTSE All-Share	4278.59	▲1.19	▲7.38	▲4.33	4278.59	3810.81	17/5/18	26/3/18
S&P 500	2727.33	▲0.156	▲0.774	▲15.7	2872.87	2357.03	26/1/18	17/5/17
Brent Oil Spot $	$80.37	▲3.7	▲12.1	▲54.3	$80.37	$44.785	17/5/18	21/6/17
Gold Spot $ per oz	$1288.95	▼-2.44	▼-4.27	▲2.27	$1356.22	$1210.35	24/1/18	7/7/17
GBP/USD - US Dollar per British Pound	1.35015	▼-0.151	▼-5.56	▲4.09	1.43407	1.26325	16/4/18	20/6/17
GBP/EUR - Euros per British Pound	1.14485	▲0.877	▼-0.93	▼-1.54	1.1661	1.0795	18/5/17	29/8/17

Top FTSE All-Share risers

No.	TIDM	Name	%chg 1w
1	OCDO	Ocado Group PLC	▲44.1
2	IWG	IWG PLC	▲34.2
3	MTC	Mothercare PLC	▲33.6
4	ZPG	ZPG PLC	▲30.6
5	SPO	Sportech PLC	▲30.4
6	888	888 Holdings PLC	▲18.7
7	WG.	Wood Group (John) PLC	▲17.9
8	GDWN	Goodwin PLC	▲17.2
9	PPB	Paddy Power Betfair PLC	▲16.9
10	WMH	William Hill PLC	▲16.4

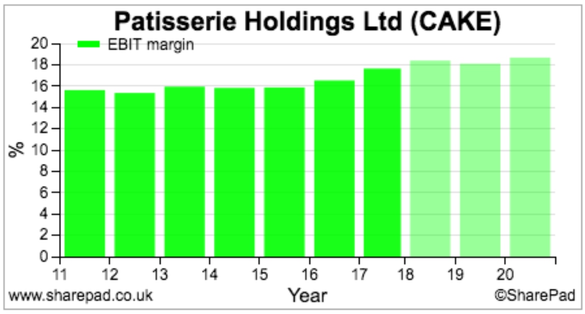
Top FTSE All-Share fallers

No.	TIDM	Name	%chg 1w
1	ITE	ITE Group PLC	▼-17.6
2	CPR	Carpetright PLC	▼-16.2
3	DIA	Dialight PLC	▼-11.6
4	CRST	Crest Nicholson Holdings Ltd	▼-9.88
5	RMG	Royal Mail Group PLC	▼-9.22
6	ARW	Arrow Global Group PLC	▼-9.22
7	PURE	PureCircle Ltd	▼-8.58
8	OTB	On The Beach Group PLC	▼-7.89
9	BT.A	BT Group PLC	▼-7.42
10	TALK	TalkTalk Telecom Group PLC	▼-6.9

Patisserie Holdings (LSE:CAKE)

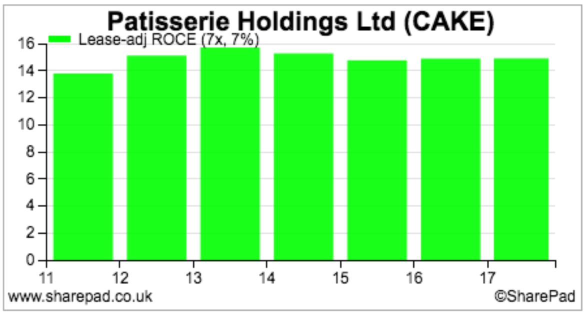
Patisserie Holdings has proven itself to be a very resilient business in a tough trading environment. The upmarket cakes and sandwiches company has been rolling out new shops at a rate of around 20 per year for the last few years.

Its business model of selling affordable treats has gone down well with British consumers. Its shops cost £250,000 to fit out, are profitable from the first week of trading and have a payback period of less than two years.



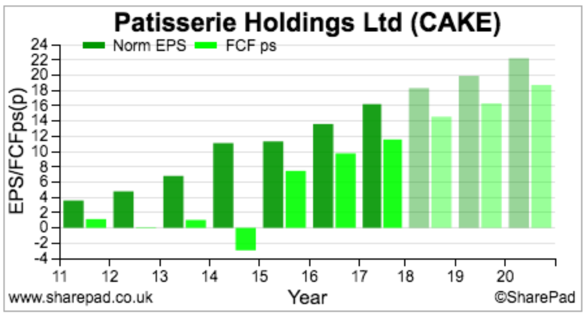
In many ways, Patisserie Holdings is very similar to Greggs (LSE:GRG) in that it is vertically integrated and supplies many of its own products to its shops. This is a good source of competitive advantage over rivals.

The company is very profitable and generates high profit margins.



When its rented shops are taken into account, the company is generating very decent returns on capital employed (ROCE) of around 15% which is a lot better than most food retail businesses.

Considering that it is spending money on opening up new stores (costing around £5m of capex per year on 20 stores), free cash generation is pretty decent. As it is not buying freehold properties, the company can fund its roll out entirely from its own cash flow and is not reliant on borrowings or raising fresh equity from shareholders.



Given its high levels of profitability combined with a self-funded roll out it is quite understandable that the company's shares have been very popular with investors. After a long period of time trading around the 300—350p range, the shares have had a strong start to 2018 and have increased by 22% since the start of 2018.

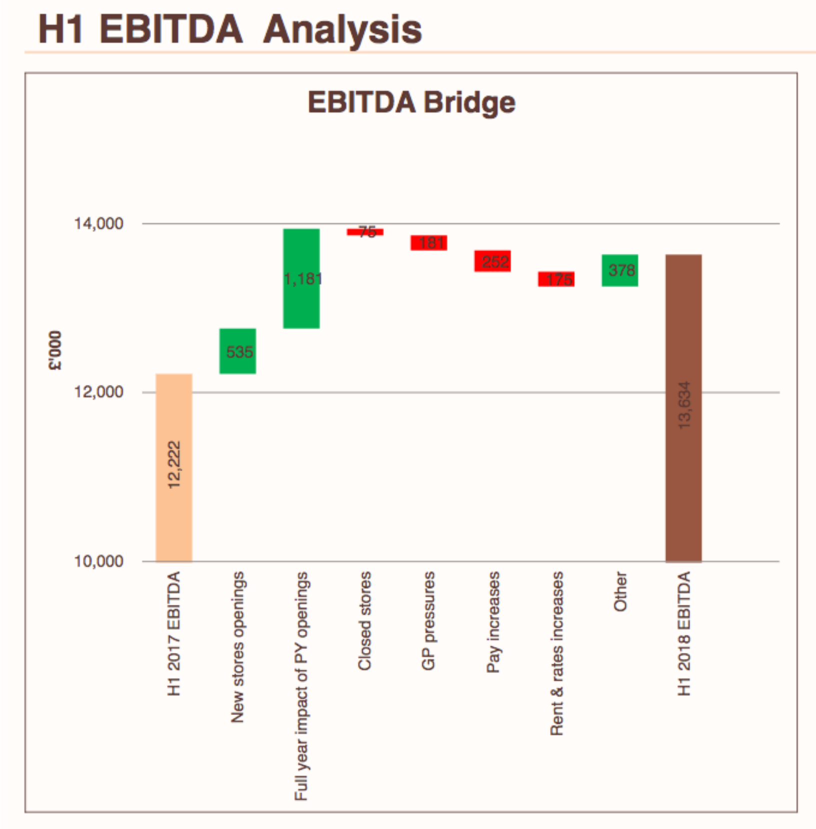
This week's half year results can best be described as solid rather than exceptional. Revenues increased by 9.1% with adjusted operating profits up by 14.1%. Given the cost pressures from wages, business rates and rents, the increase in operating profit margins is a good result.

The table below gives some more detail on how the company's performance has evolved over the last couple of years.

Sales	H1 16	H2	2016	H117	H217	2017	H1 2018	TTM
Patisserie Valerie	34953	38952	73905	40437	43902	84339	45786	89688
Druckers	6851	6459	13310	7009	6050	13059	6698	12748
Baker & Spice	2231	2470	4701	2374	2364	4738	2375	4739
Flour Power	1830	1854	3684	1795	1839	3634	1697	3536
Philpotts	4903	5341	10244	4732	5451	10183	4878	10329
Operating profit	**H1 16**	**H2**	**2016**	**H117**	**H217**	**2017**	**H1 2018**	**TTM**
Patisserie Valerie	6575	7238	13813	7823	8444	16267	8934	17378
Druckers	644	569	1213	724	478	1202	768	1246
Baker & Spice	523	588	1111	518	616	1134	519	1135
Flour Power	254	280	534	250	315	565	257	572
Philpotts	619	589	1208	708	737	1445	723	1460
Sales growth	**H1 16**	**H2**	**2016**	**H117**	**H217**	**2017**	**H118**	**TTM**
Patisserie Valerie				15.69%	12.71%	14.12%	13.23%	
Druckers				2.31%	-6.33%	-1.89%	-4.44%	
Baker & Spice				6.41%	-4.29%	0.79%	0.04%	
Flour Power				-1.91%	-0.81%	-1.36%	-5.46%	
Philpotts				-3.49%	2.06%	-0.60%	3.09%	
Profit margins	**H1 16**	**H2**	**2016**	**H117**	**H217**	**2017**	**H118**	**TTM**
Patisserie Valerie	18.81%	18.58%	18.69%	19.35%	19.23%	19.29%	19.51%	19.38%
Druckers	9.40%	8.81%	9.11%	10.33%	7.90%	9.20%	11.47%	9.77%
Baker & Spice	23.44%	23.81%	23.63%	21.82%	26.06%	23.93%	21.85%	23.95%
Flour Power	13.88%	15.10%	14.50%	13.93%	17.13%	15.55%	15.14%	16.18%
Philpotts	12.62%	11.03%	11.79%	14.96%	13.52%	14.19%	14.82%	14.13%

The business and its expansion is driven by its Patisserie Valerie shops. What we can see here is that its sales growth has remained healthy - up by 13.2% during the first half of the year. Profit margins nudged up slightly.

My one continuing gripe about this company is that it does not disclose its like-for-like sales performance which is a key measure of the health or otherwise of a retail business. It does however provide a bridge from how EBITDA has changed from one year to the next.



What we can see here with the green bars is the positive contribution to EBITDA from new stores opened in the period and from the full year impact of previous new openings. During the first half of 2018, £1.7m of extra EBITDA came from these sources which was offset from closed stores and cost pressures.

Patisserie Holdings (£m)	FY15	H116	FY16	H117	FY17	H118
Opening EBITDA	**15.3**	**8.7**	**18.8**	**10.6**	**22.2**	**12.2**
New Stores	1.0	0.7	1.6	0.7	1.8	0.5
FY contribution fron new stores	1.3	1.2	1.5	1.1	1.5	1.2
Closed stores	0.0	0.0	-0.1	0.0	-0.2	-0.1
Closing EBITDA	**18.8**	**10.6**	**22.2**	**12.2**	**25.6**	**13.6**
Stores	174	177	184	192	199	206
EBITDA growth from new	**15.0%**	**21.6%**	**16.6%**	**17.3%**	**14.9%**	**14.0%**
Total EBITDA growth	22.4%	21.3%	18.1%	15.6%	15.7%	11.6%

Looking back over the last few years, we can see the contribution to EBITDA growth from newly opened stores. There has been a slowdown over the last year as the growth of new store openings has slowed down. Total EBITDA growth has also slowed down due to cost pressures.

My guess is that the overall mix within the stores is generally alright. Store numbers are 14 or 7.3% higher than a year ago whilst EBITDA is growing at a faster rate. That said, I do have some concerns about growth going forward.

The company says that it is still on track to open 20 new stores this year. It still has a long pipeline of potential sites and new stores look to be performing well. That said, I have some concerns about the existing stores, particularly the concessions in Debenhams stores.

Debenhams was seen as a way of Patisserie Holdings getting high street exposure for its brand at a cheap price. However, Debenhams is struggling and there are grave doubts about its future. Were Debenhams to close down, this would have implications for the 16 Patisserie Valerie concessions that were in place at the end of last year. These concessions could be a drag on future growth.

Looking at the current full year forecasts for the year to September 2018, I'd say that the company should be able to meet current year forecasts. Trailing twelve-month profit before tax is currently running at £21.5m compared with a current consensus estimate of £23m.

Patisserie Holdings Analysis £'000)	H1 16	H2 16	FY16	H1 17	H217	FY17	H118	TTM
Revenue	49984	54157	104141	55488	58709	114197	60522	119231
cost of sales	-10825	-12007	-22832	-12188	-12743	-24931	-13465	-26208
Gross profit	39159	42150	81309	43300	45966	89266	47057	93023
Administration expenses	-30774	-33325	-64099	-33599	-35522	-69121	-35983	-71505
Trading profit	**8385**	**8825**	**17210**	**9701**	**10444**	**20145**	**11074**	**21518**
Finance costs	0	-6	-6	0	-36	-36	0	-36
Finance income	0	0		0	44	44	1	45
Profit before tax	**8385**	**8819**	**17204**	**9701**	**10452**	**20153**	**11075**	**21527**
Tax expenses	-1707	-1762	-3469	-1756	-2033	-3789	-2020	-4053
Profit for the period	**6678**	**7057**	**13735**	**7945**	**8419**	**16364**	**9055**	**17474**
Operating margin	**16.78%**	**16.30%**	**16.53%**	**17.48%**	**17.79%**	**17.64%**	**18.30%**	**18.05%**
Tax rate	**20.36%**	**19.98%**	**20.16%**	**18.10%**	**19.45%**	**18.80%**	**18.24%**	**18.83%**
Net profit margin	**13.36%**	**13.03%**	**13.19%**	**14.32%**	**14.34%**	**14.33%**	**14.96%**	**14.66%**

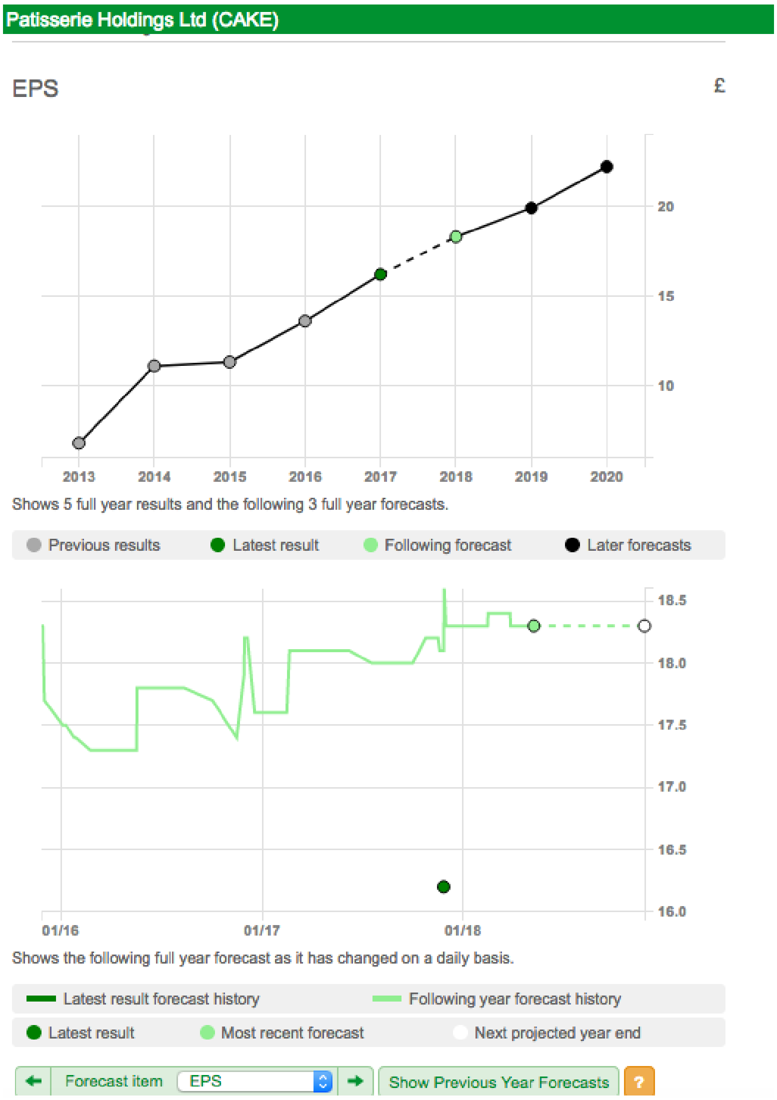
New store openings in the second half of the year and the full year impact of recently opened stores should see the company meet but probably not beat forecasts. Online sales are growing but from a very small base and are unlikely to have a meaningful impact on results just yet.

Patisserie Holdings Ltd (CAKE)

FORECASTS

£ millions unless stated

Year	2018		2019		2020	
Turnover	125.1	+9.6%	138.1	+10.3%	149.1	+8.0%
EBITDA	28.4	+11.0%	31.0	+9.1%	34.0	+9.5%
EBIT	23.0	+14.3%	25.0	+8.6%	27.8	+11.4%
Pre-tax profit	23.0	+14.0%	25.0	+8.9%	27.7	+10.7%
Post-tax profit	18.5	+13.3%	20.5	+10.7%	23.1	+12.3%
EPS (p)	18.3	+13.0%	19.9	+8.7%	22.2	+11.6%
Dividend (p)	4.1	+13.9%	4.7	+14.6%	5.3	+12.8%
CAPEX	9.0	+3.2%	9.0	0.0%	9.0	0.0%
Free cash flow	14.7	+25.8%	16.4	+11.9%	18.9	+14.9%
Net borrowing	-32.3		-44.2		-58.0	



As you can see from the chart above, analysts' forecasts for EPS have not moved for a while and I would expect that to remain the case.

This situation could change if the company decides to buy another business. It mentions that it is looking at acquisition opportunities and with net cash of £28.8m on the balance sheet I don’t think it would be much of a surprise if it bought another bakery business.

I think Patisserie Holdings is a very solid well-run business that should be able to keep growing its profits for a while yet. My only question is the rate of profits growth and whether it might slow down more than people currently expect. At 431p, the shares trade on a one year forecast rolling PE of 22.4 times. This falls to 20.8 times when adjusted for net cash. That looks about right to me.

easyJet (LSE:EZJ)

easyJet, along with other low-cost carriers has transformed short-haul air travel in Europe. It has eaten the lunch of legacy flag carriers such as British Airways and has become one of the most successful airline brands.

The company has thrived by keeping things simple and serving its customers well. It has only one aircraft type (A320), one brand and only sells tickets over the internet. Unlike some other airlines, it flies where its customers want to go to rather than where it can get the cheapest airport deals.

The European airline industry has been going through a rough patch. Monarch, Air Berlin and Alitalia have all gone bankrupt. Ryanair has been wrestling with problems whilst there have been lots of strikes at Air France. In the meantime, easyJet has been doing rather well based on the evidence of this week's half year results.

A year or so ago, there was a concern amongst some investors that there was too much capacity entering the European short-haul market that would push down prices and profits. With the bankruptcies of some airlines, capacity has actually come out of the market and fares have gone up.

EasyJet's revenue per seat (excluding the Air Berlin operations at Tegel airport) increased by 12% during the first half of the year due to higher fares and selling more on-board products to passengers. The cost per seat was broadly flat due to lower fuel costs and more efficient aircraft offsetting higher pay for staff.

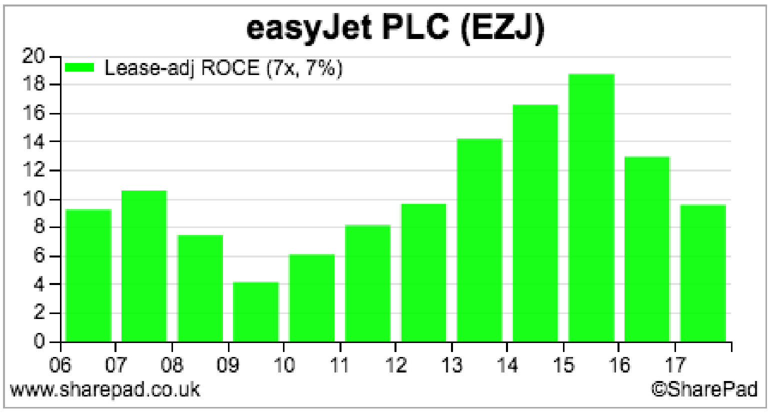
With 4.6% more passengers flown and with its planes 1.7% fuller (a higher load factor), the company reported a nice increase in revenue and saw profit before tax swing from a £212m loss a year ago to a small profit of £8m. The timing of Easter also gave the company a boost in the first half of the year compared with last year.

FINANCIAL OVERVIEW

£m (Reported)	**H1 2018**	**H1 2017**	**H1 2018**	**H1 2018**	**H1 2017**
	Ex-Tegel		**Tegel**	**Total**	
Revenue	**2,141**	**1,827**	**42**	**2,183**	**1,827**
Headline costs excluding fuel	(1,683)	(1,580)	(57)	(1,740)	(1,580)
Fuel	(450)	(459)	(11)	(461)	(459)
Headline profit/(loss) before tax	**8**	**(212)**	**(26)**	**(18)**	**(212)**
Headline tax (charge)/credit	(2)	40	7	5	40
Headline profit/(loss) after tax	**6**	(172)	**(19)**	**(13)**	**(172)**
Non-headline loss after tax	(22)	(20)	(19)	(41)	(20)
Total loss after tax	**(16)**	**(192)**	**(38)**	**(54)**	**(192)**

£ per seat (Reported)	**H1 2018**	**H1 2017**	**H1 2018**	**H1 2018**	**H1 2017**
	Ex-Tegel		**Tegel**	**Total**	
Revenue	**54.64**	**48.80**	**35.97**	**54.10**	**48.80**
Headline costs excluding fuel	(42.96)	(42.18)	(48.02)	(43.11)	(42.18)
Fuel	(11.48)	(12.27)	(9.45)	(11.42)	(12.27)
Headline profit/(loss) before tax	**0.20**	**(5.65)**	**(21.50)**	**(0.43)**	**(5.65)**
Headline tax (charge)/credit	(0.05)	1.06	5.95	0.11	1.06
Headline profit/(loss) after tax	**0.15**	**(4.59)**	**(15.55)**	**(0.32)**	**(4.59)**
Non-headline loss after tax	(0.54)	(0.51)	(16.73)	(1.02)	(0.51)
Total loss after tax	**(0.39)**	**(5.10)**	**(32.28)**	**(1.34)**	**(5.10)**

Whilst the results were good, easyJet knows that it has work to do to become more profitable. Its ROCE has fallen significantly over the last couple of years from a very good level to a quite modest one.



The company has a plan to increase profits per seat with the aim of driving ROCE higher.

easyJet already carries a lot of business passengers (13.7million during the first half of the year) but wants to carry a lot more. Business passengers will pay more for their tickets with allocated seating, extra bag allowances, and frequent flights to key European cities. The company does well on some routes with 60% of its passengers travelling on business, but it needs to do better on other routes. Improvements in this area should drive up passenger yields (revenue per seat).

Perhaps the most interesting new initiative is a significant investment in easyJet holidays. This looks a very good decision to me. In last week's newsletter I analysed On the Beach (LSE:OTB), an online travel business that is very profitable. On the Beach is essentially a middleman, buying seats on airlines and rooms in hotels and getting paid commissions on a low-cost base.

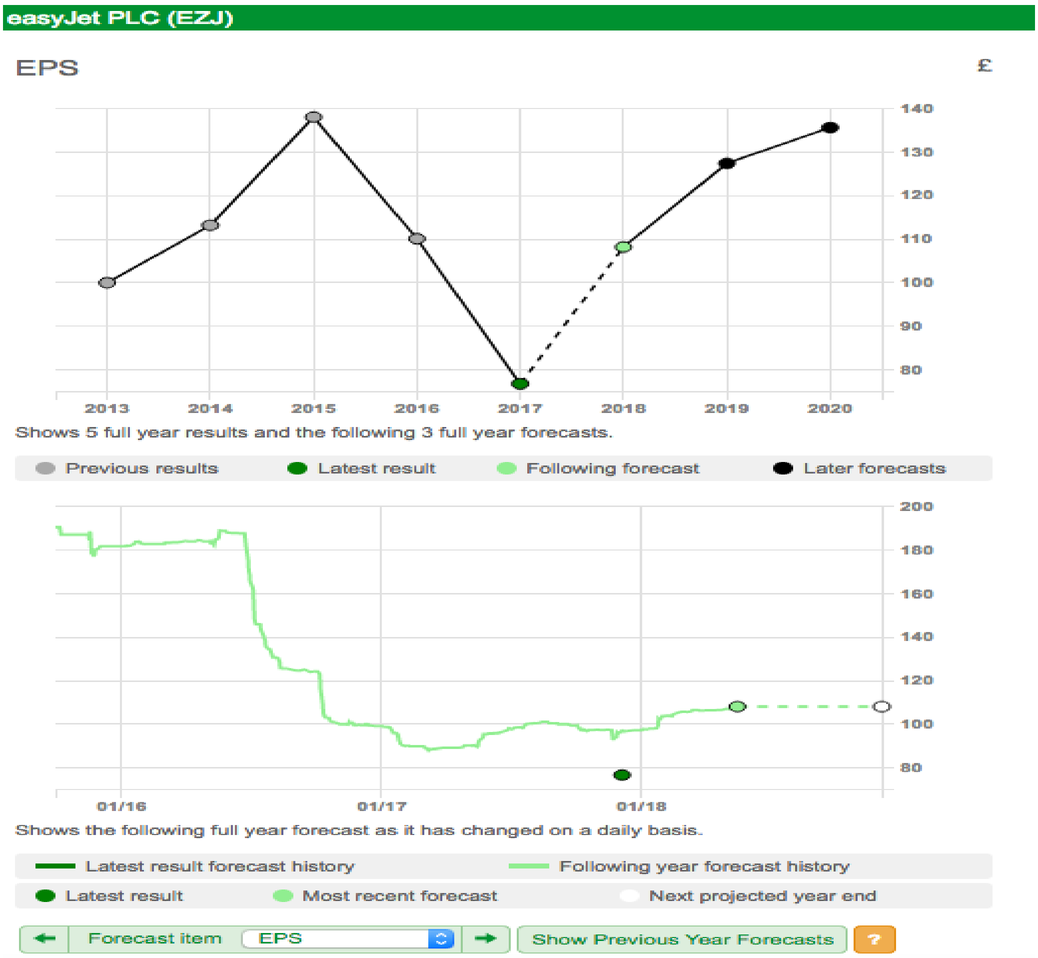
easyJet, quite sensibly is looking to take a slice of that market. It already has the plane seats and flies to popular holiday destinations and is now setting about building up relationships with hotel owners. This could turn out to be a very decent source of incremental profit for the company.

easyJet PLC (EZJ)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	5,655.2	+12.1%	6,235.1	+10.3%	6,696.0	+7.4%
EBITDA	780.2	+28.1%	904.9	+16.0%	975.4	+7.8%
EBIT	556.6	+34.4%	660.1	+18.6%	708.4	+7.3%
Pre-tax profit	557.0	+44.7%	623.2	+11.9%	684.7	+9.9%
Post-tax profit	431.7	+41.5%	515.7	+19.5%	547.3	+6.1%
EPS (p)	108.2	+40.9%	127.4	+17.7%	135.6	+6.4%
Dividend (p)	50.3	+23.0%	64.7	+28.6%	74.2	+14.7%
CAPEX	1,195.7	+89.8%	884.6	-26.0%	1,005.9	+13.7%
Free cash flow	-562.0		-73.0		-92.6	
Net borrowing	255.8	-1.6%	667.8	+161.0%	867.8	+29.9%
NAV	3,044.0	+8.6%	3,246.0	+6.6%	3,483.0	+7.3%
Like for like sales growth %	10.4		7.5	-27.9%	3.2	-57.3%

The outlook for the rest of 2018 looks to be pretty good. easyJet is increasing capacity by 5% in the second half of the year and expects yields to be slightly higher. Fuel costs are expected to be lower and the effect of foreign exchange rates is expected to have a positive impact on profits.



The company is guiding investors towards a profit before tax figure between £530m and £580m. The current consensus amongst City analysts is £557m which is bang in the middle of that range. EPS forecasts have been nudging up since the start of 2018 but I would not expect any immediate upgrades in the light of these results.

TIDM	Name	Close	Market Cap. (m)	PE roll 1	Enterprise value / fc Norm EBIT	fc Norm EPS %chg
DTG	Dart Group PLC	852.5p	£1266.8	14.0	10.145	▲21.6
EZJ	easyJet PLC	£17.41	£6915.4	14.5	12.892	▲40.9
IAG	International Consolid…	685.8p	£14042.8	6.7	6.3622	▲21.4
RYA	Ryanair Holdings PLC	€15.475	€17964.2	12.8	10.843	▲13.6
WIZZ	Wizz Air Holding PLC	£32.00	£2327.6	13.7	5.2819	▲13.5

easyJet shares trade at a premium to its peers on a rolling PE and forecast EV/EBIT basis. That said, even though the shares have had a very strong run, I think they could still offer reasonable long-term value given the strength of the company's business model and its potential to improve its profits.

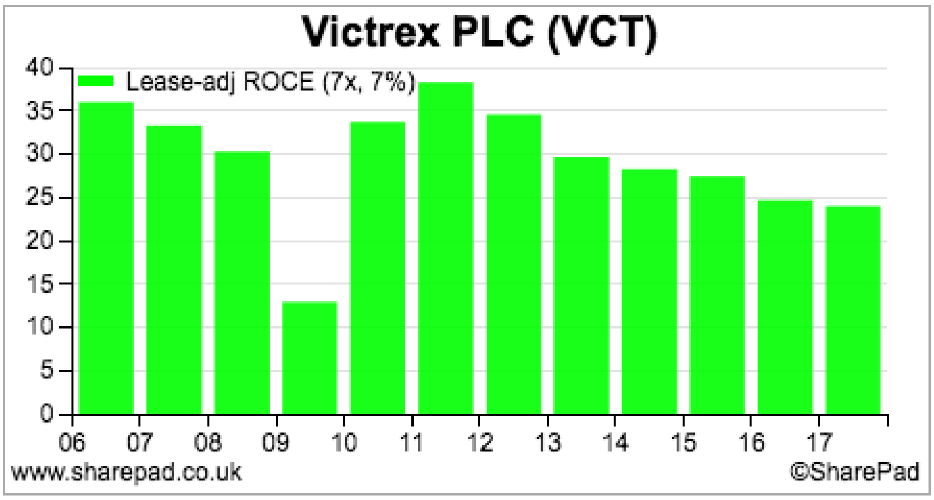
Victrex (LSE:VCT)

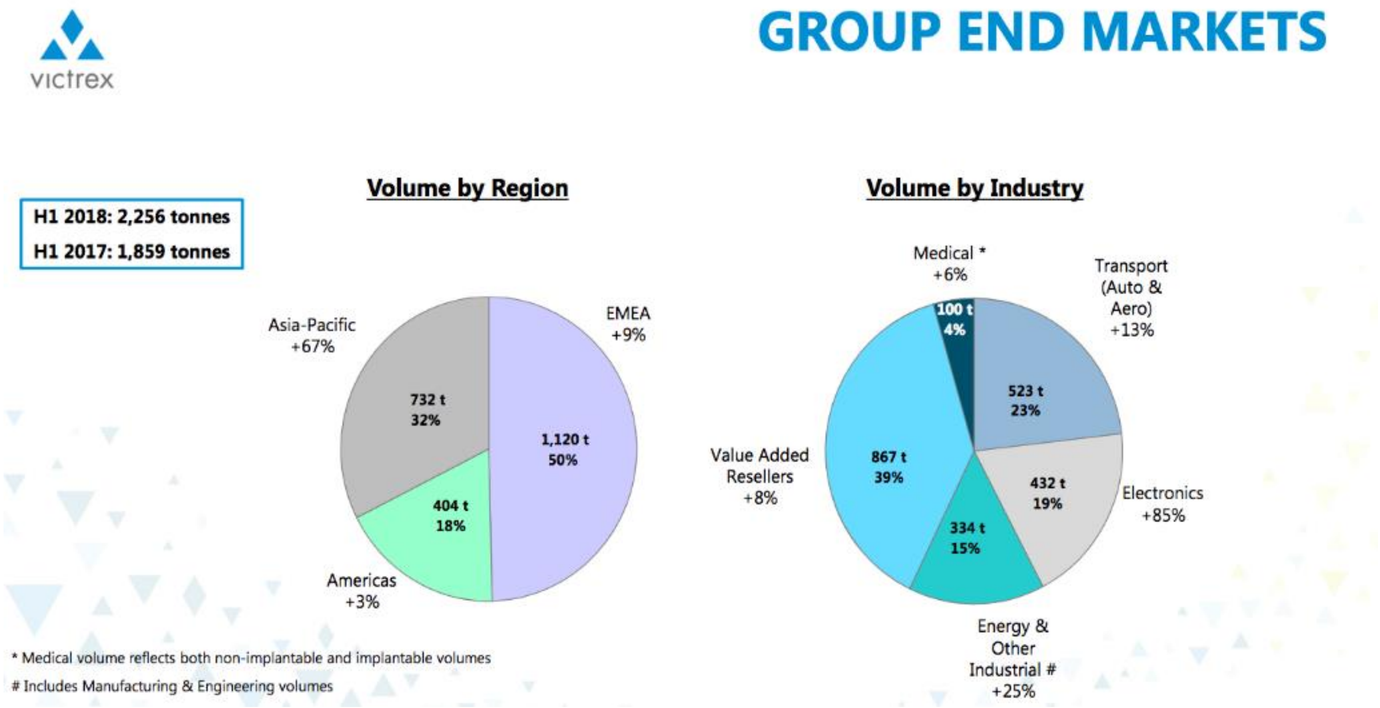
Disclosure: I currently own shares in Victrex

Victrex is the biggest producer of a high-end plastic material (often called a polymer) called PEEK. PEEK is very strong, light and can be made into lots of value added and problem-solving products. Victrex is the largest producer of PEEK in the world with annual capacity of just over 7,000 tonnes and has built a reputation for making high quality products.

The company's strategy is to move away from the upstream manufacturing of PEEK which is very price competitive to downstream manufacturing of valued added parts in target markets. If it can successfully do this, then it stands a good chance of preserving its very high levels of profitability. Last year, its profit margins were 38% and its ROCE was 24%. ROCE has been on a steadily downwards trend in recent years.

A large chunk of the company's PEEK production is sold to value added resellers with the rest focused on five key sectors. The business is also dominated by overseas sales which means that changes in foreign exchange rates can have an impact on reported profits. The business split is shown below.





This week, Victrex delivered a very decent set of half year results. They were given a big helping hand by favourable currency movements but the underlying business has been performing well.

Sales volumes increased by 21% to 2,256 tonnes, which helped to drive a revenue increase of 27% and a pre-tax profit increase of 26%. The company benefits from a favourable tax rate where the UK government gives tax breaks on qualifying patents. This resulted in a sharp fall in the tax rate which led to half year EPS increasing by 39%.

Business Segment	H1 2018 volume growth
Energy & other Industrial	+25%
Value Added Resellers	+8%
Automotive	+12%
Aerospace	+21%
Electronics	+85%

The company's Industrial division (83% of total sales) has seen strong demand as shown in the table above. Revenues for the half year were up by 36%, helped by a large Consumer Electronics order. Oil and gas saw strong demand, with the company's PEEK pipe and tape making good progress.

Automotive products such as braking systems, gears and chassis applications are performing well as car manufacturers continue to seek to build cars that weigh less without sacrificing strength or performance.

Victrex seems to be very optimistic about the potential for PEEK products such as gears and the use of PEEK in electric vehicles.

Similarly, in Aerospace, the company is bullish about the strength and weight-saving properties of PEEK to increase future sales, although competition in this sector is quite fierce.

The Medical division (17% of total sales) had a disappointing first half. The market for PEEK products used in spinal operations is very mature whilst there has been a loss of market share to titanium products. Longer term, the company is pinning its hopes on breakthrough products in areas such as dental implants, trauma and knee replacement.

In total, Victrex's existing business seems to be doing very well. It has a well thought out strategy to grow by selling new, differentiated, value added products but these only account for 4% of total sales at the moment. The medium-term aspiration is for them to account for 10-20% but this is not likely to happen any time soon without a significant breakthrough with customers.

One of the attractions of Victrex shares in recent years has been the payment of special dividends (in 2014 and 2017) as the company has returned surplus cash to shareholders. The policy has been to return half of its net cash balance to shareholders subject to a minimum special pay-out of 50p per share. The threshold for the payment of a special dividend is that the company must have a minimum net cash balance of £85m.

Victrex PLC (VCT)

FORECASTS — £ millions unless stated

Year	2018		2019		2020	
Turnover	329.6	+13.6%	327.4	-0.7%	345.5	+5.5%
EBITDA	144.1	+11.7%	144.0	-0.0%	151.3	+5.1%
EBIT	126.5	+13.5%	125.6	-0.7%	132.9	+5.8%
Pre-tax profit	125.3	+12.9%	126.8	+1.2%	136.8	+7.9%
Post-tax profit	110.3	+10.9%	113.1	+2.6%	121.7	+7.6%
EPS (p)	129.9	+11.8%	130.9	+0.8%	137.6	+5.1%
Dividend (p)	102.7	+90.9%	99.4	-3.2%	99.5	+0.1%
CAPEX	20.1	+20.4%	29.6	+47.4%	30.1	+1.6%
Free cash flow	100.3	-0.6%	99.8	-0.5%	108.0	+8.2%
Net borrowing	-107.7		-98.7		-101.5	

It is expected to meet this threshold in 2018 but I would not bet on a special dividend being paid. The company is suggesting that it may have to invest in additional polymer manufacturing capacity if current demand trends continue and that this would take precedence over a special dividend payment.

"With capital expenditure having reduced from historic levels, and reflecting the post-tax benefit to earnings and cash from Patent Box, the Board is assessing distribution options for future shareholder returns, ***whilst noting that growth investment remains the priority, including the potential requirement for investment in new or additional polymer manufacturing capacity within the current five-year strategy plan.*** *Several options for future dividend distribution are under consideration."*

The other key issue with this company is the future growth rates in its profits. Many of its markets are cyclical but are supported by trends for lighter and stronger products which can offset some of this. Exchange rates are set to hold back profits growth in the second half of 2018 and 2019.

With little in the way of profit growth expected until 2020, the shares are arguably a little bit expensive on a one year rolling forecast PE of 20.8 times or 19.9 times when adjusted for net cash balances.