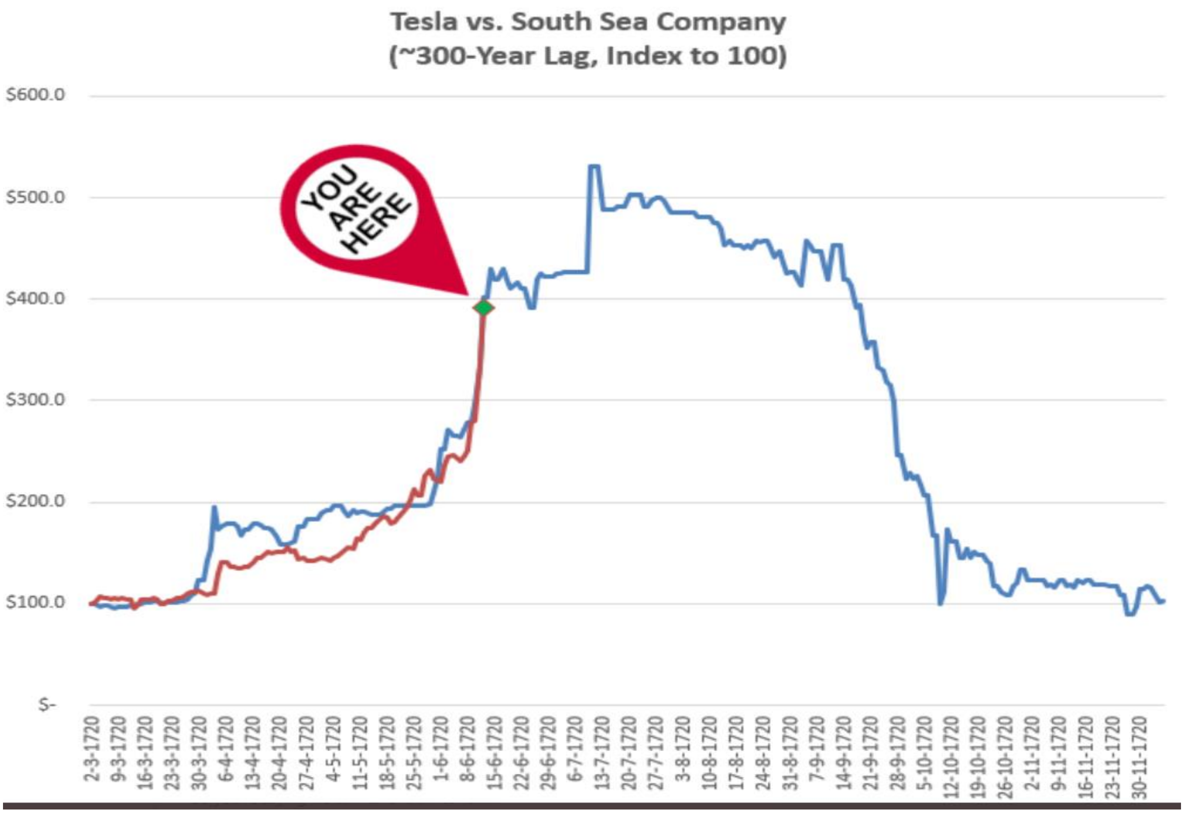
Jeremy Grime's Weekly Commentary

Exclusively for SharePad & ShareScope subscribers

Employee Culture

10 February 2020

Last week's price action in Tesla served as confirmation of the bubble, which is cause to maintain a bearish outlook for markets. It is a problem caused by excessive debt, just as the South Sea bubble was caused by the debt after an expensive war with France. We can't tell exactly when it will burst but when it does we should stand at a safe distance. For that reason quality is currently the watchword which is always difficult to measure. I found this unsourced chart last week on Twitter from @keubiko.



Quality

Analysts are trained to look at financial metrics such as ROE and operating margins as a measure of quality and every fund manager will say they like a quality management team but as yet I haven't found a way of measuring a quality management team. On 13 January this article discussed culture, suggesting that an equity stake, a focus on the customer, and respect for staff are ways of estimating quality, alongside the financial metrics of ROE and operating margins. Remuneration can also provide a clue as to management motivation. Often the best management teams don't have an LTIP, rather they have an equity stake in the business that motivates them. Examples such as Ashmore Group Plc and Integrafin Plc come to mind. Fund managers have had an apparent advantage over retail investors historically as they have better access to management. Typically, they will be offered an hour's on to one meeting with management on each set of results and also have access to specific visits to the firms' offices.

Now it seems nearly every fund manager has a slide in their marketing presentation describing their approach to Environmental, Social and Governance issues ("ESG"), which are always described as "high standards". When the fund manager attends a company's premises' they are always escorted by management so never get a chance to discuss the company with the employees. But in this online era we have www.glassdoor.com where employees post their reviews of the company which can provide a vital insight to the culture of the company.

Glassdoor Reviews

A company with a strong positive culture will enable management to hold together a business when times get tough enabling them to take market share during a downturn and grow into a larger company to become highly profitable when their specific market recovers. And hence provides a small company with the ability to become a large company. While those with a poor culture will tend to fall apart when times get tough.

I have reviewed all of the 864 AIM listed companies' listings on Glassdoor. Many have no reviews. Some only have 1 review who may be from the CEO or a disgruntled employee which may not be representative, so I have excluded all companies with less than 3 reviews. It is the outliers that are interesting. Those with a strongly positive culture have largely performed well while those with a negative culture have performed poorly in share price terms.
Hence a check of our shareholding may highlight the "value trap" stocks. That is those stocks that we hold because they look anomalously cheap and we hope they recover when over time they stay cheap. At the other end of the scale it may help us to run our winners and have faith in the high quality stocks that keep getting more expensive rather than selling our expensive stocks which personally is my biggest investing regret.

An average rating is one with a score between 3 and 4. Above 4.5 out of 5 is exceptional while below 2.5 is a fairly damning indictment of a company's culture by its own staff.

Quality

The list looks like this:

Company	Score	Number of reviews	Mkt Cap £m	Business
HML Holdings	4.6	46	£15	Property Management
Abcam	4.7	186	£2,677	Biotech
Actual Experience	4.7	10	£24	Lossmaking cloud analytics
Alpha FX	4.7	72	£443	FX
Gateley	4.8	41	£251	Lawyer
Cropper (James)	4.9	5	£126	Paper manufacturer
Polar Capital	4.9	6	£558	Fund Manager
Prime People	5	7	£12	Recruiter

Source: Glassdoor

A brief comment on each may be useful

- **HML Holdings** According to the report and accounts the company employs 549 people so 46 reviews is 8% of the workforce. There are no forecasts out from broker Finncap which is always a cause for concern and for 549 employees to produce turnover of only £30m it would seem to be hard to scale the business.
- **Abcam** Trading on a PER of 44X delivering a ROE of 15% this looks like a quality situation.
- **Actual Experience** This company is loss making and there are no forecasts in the market raising the possibility that the company may be run for the staff rather than shareholders
- **AlphaFX** This is a highly motivated workforce. Many CFO's have told me they keep getting calls from AlphaFx selling their FX services. Rated at 39X.
- **Gateley** The CEO said at IPO he intended the company to be "dull". But it appears the lawyers like working there which is important for a legal services business. PE 15X
- **Cropper (James)** It is rare to see a paper manufacturer rated on 28X PE. The Cropper family own 58% and it is forecast to earn a 20% ROE this year. Quality situation.
- **Polar Capital** The fund managers may enjoy working there but the company has been underperforming.
- **Prime People** I am unsure at the presence of a recruiter on the list as it could well be that the recruiters have been posting their own reviews knowing their customer tend to look at these scores. So, I am inclined not to trust this rating.

Poorly Rated

The naughty step looks like this:

Company	Score	Number of reviews	Mkt Cap (m)	
Arena Events	2	9	£39	Events management
Caretech Holdings	2.1	37	£541	Care Services
EKF Diagnostics	2.1	7	£148	Medical testing
Morses Club	2.1	10	£165	Sub Prime lender
Origin Enterprises	2.1	6	E455	European agri services
Brooks Macdonald	2.2	31	£341	Wealth Manager
Celtic Plc	2.2	12	£137	Football
Dods Group	2.2	25	£21	Media Services
Iofina	2.2	4	£45	Chemicals
Walker Greenbank	2.2	5	£52	Interior furnishings
Applegreen	2.3	115	£531	Petrol Stations
Bonhill	2.3	10	£14	Publishing
Escape Hunt	2.3	11	£4	Experiences
Hvivo	2.3	87	£14	Clinical services
Scapa Group	2.3	46	£388	Adhesive manufacturer
Uniphar	2.3	41	E362	Healthcare services
Brady	2.4	47	£15	Trading software
Ideagen	2.4	50	£453	Compliance software
Pebble Beach	2.4	12	£11	Content management software
Stanley Gibbons	2.4	31	£14	Stamps and coins

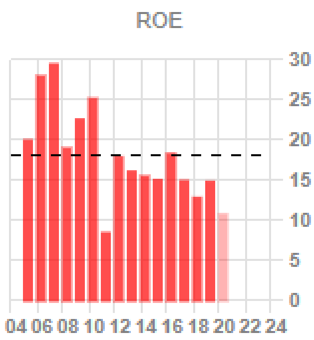
Source: Glassdoor

I would highlight a number of points:

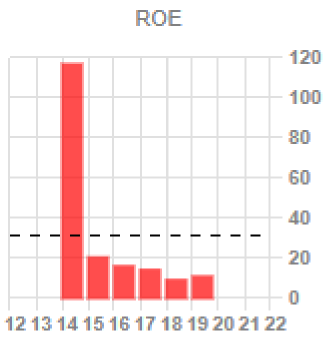
- The high number of negative reviews for **Applegreen** suggests there could be an issue here
- In the healthcare sector **Caretech**, **Hvivo** and **Uniphar** seems strange to have a lot of unhappy staff.
- **Ideagen** I covered last week finding concern over their underlying returns which is now compounded when I see this acquisitive company also has unhappy staff.
- **Brooks Macdonald** has been restructuring for a number of years now and as a people business this is concerning.

Applegreen and Caretech both have declining ROE charts (see below) which is a concern but as Caretech is on a lowly PE of 11X and Applegreen is on a higher PE of 17 it may be worth taking a further look at Applegreen.

Caretech



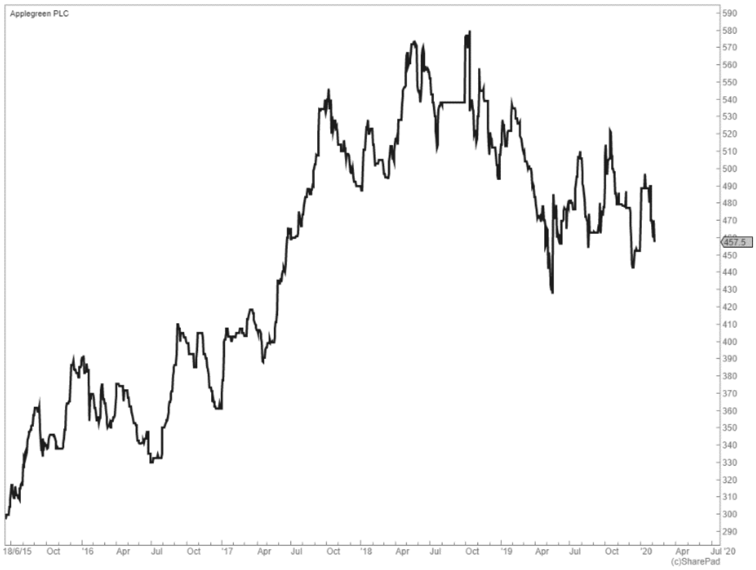
Applegreen



Source: SharePad

Applegreen PLC

Share Price 457p
Mkt Cap £531m



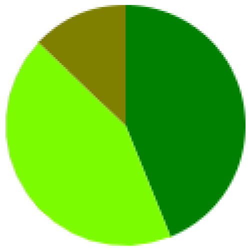
Source: SharePad

Business

This Irish petrol forecourt retailer was brought to market in 2015 since then it has done well as the acquisition of forecourts has proved rewarding. The company has recently been acquiring forecourts in the US so the turnover split is now across the UK, Ireland and the US.

ACTIVITY BREAKDOWN
By operating turnover

Last updated 31/12/18



Region	Turnover €	%
United Kingdom	883.1m	43.9%
Ireland	869.2m	43.2%
United States of America	260.3m	12.9%

Reviews

Some of the reviews are shocking. Here is one:

"Horrible management Zero hour contracts Treat staff horrible Offer no hours one week NEVER TAKE TIME OFF ILL disciplinary for nothing Staff always leaving and complaining No discount and no support You might do all the hours in the world and get no respect for it"

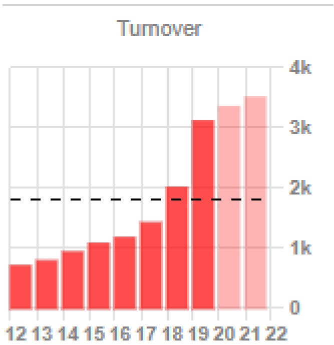
I find the health and safety comments in this one concerning:

"Don't follow rules and regulation. Your safety is at risk, management don't take you seriously or any concerns you have, not organised rota are done day before or two days in advance, theifs about stealing products, you are left alone to lock up without no training provided by the managers. You work alone most times u till the very end. Company doesn't appreciate you. Needs new management above"

It sounds rather similar to complaints we have heard over Sports Direct which sells low priced sports gear while this company sells low priced petrol so we have to question the sustainability of the model.

Financials

On a PER of 17X the company is seen as a growth situation.



The company has been highly acquisitive so an analysis of returns and remuneration along the lines I did for Ideagen may be an appropriate way to take a look at this. In the meantime the half year results to June 2019 reported like for like fuel revenue growth of 8.4% contributing to 73% revenue growth to €1.5bn. Adjusted EBITDA was up 200% to €58.9m representing a thin 4% margin. Net debt was €471m, but this rises to £1.1bn including lease liabilities. With finance charges of €42m (in 6 months!) the debt is expensive leading to PBT of €10.2m on a statutory basis.

Remuneration

A look at the remuneration scheme may shed some light on management motivation. 80% of the bonus is judged on adjusted EBITDA targets. Excluding interest from the bonus measure will naturally incentivise management to use high leverage. The LTIP is based 50% on EPS growth of CPI plus 9% which again will incentivise high leverage.

Annual Report

The last annual report was 2018 which shows headlines of a 46% increase in adjusted EBITDA while reported profit after tax fell 29%, largely on account of the €8.5m of non-recurring charges of which €7.2m were the acquisition cost of a controlling stake in Welcome Break. The adjustments and changes in accounting policy make this hard to analyse with a high degree of certainty so if we take a look at the total assets involved and compare that to the adjusted EBITDA we may get an idea as to whether the business is sustainable. The return on total assets looks to be 10.5% as below.

	€'000
Total Assets Dec 18	1,332,565
Add accumulated amortisation	2,586
	1,335,151
2019 EBITDA estimate	139,600
ROA	**10.46%**

Source: annual report

Which compares to bank facilities from Ulster Bank and Allied Irish Bank at LIBOR plus 2.75% rising to 3.5% by 2023 with some further junior debt at 8%. On the face of it this seems to work when the company earns a 10.5% return on its assets and finances them with debt at perhaps 4%-8%., although the finance charge of €8.6m for the year to Dec 2018 when the company finished the year at a high debt level of €708m would imply an interest cost above 10%.

Conclusion

This company is a hugely leveraged play on petrol contracts. Ignoring the fact that huge capex is going to be required in the coming years as cars convert to electric. There may well be reason to question the company's policy of depreciating plant and equipment over 20 years when the sale of new petrol and diesel vehicles has been outlawed from 2035 this week, which is only 15 years time. The staff are unhappy and it operates on thin margins with a remuneration scheme that incentivises high leverage. The business model resembles that of a bank rather than a retailer. I can only hope that more retailers don't follow this model. It will end in tears.

Summary

In a liquidity bubble caused by cheap money quality stocks are the order of the day, but measuring quality is subjective. But in this online era we have ways of seeing staff reviews online as well as other sites such as Feefo and Trustpilot which can tell a desktop researcher what is going on under the covers. The high quality companies become apparent from these searches as well as the companies which are operating as leveraged bank business models where staff interests become sidelined. This is an era to watch for quality. Investors may wish to pay attention to the culture of the list of stocks below as they report.

Forthcoming Events

Company	Date	Event
Celtic Plc	12-Feb-20	H1 Results
Brooks Macdonald	05-Mar-20	H1 Results
Caretech Holdings	05-Mar-20	AGM
Abcam	09-Mar-20	H1 Results
Applegreen	19-Mar-20	FY Results
Brady	25-Mar-20	FY Results
EKF Diagnostics	31-Mar-20	FY Results
Origin Enterprises	31-Mar-20	H1 Results
Pebble Beach	31-Mar-20	FY Results
Alpha FX	05-Apr-20	FY Results
Arena Events	16-Apr-20	FY Results
Bonhill	26-Apr-20	FY Results
Hvivo	26-Apr-20	FY Results
Iofina	01-May-20	FY Results
Morses Club	01-May-20	FY Results
Escape Hunt	13-May-20	Fy Results
Walker Greenbank	17-May-20	FY Results
Actual Experience	20-May-20	H1 Results
Scapa Group	10-Jun-20	FY Results
Prime People	19-Jun-20	FY Results
Polar Capital	24-Jun-20	FY Results
Cropper (James)	25-Jun-20	FY Results
Dods Group	26-Jun-20	FY Results
HML Holdings	02-Jul-20	FY Results
Uniphar	12-Jul-20	FY Results
Ideagen	17-Jul-20	FY Results
Gateley	23-Aug-20	FY Results
Stanley Gibbons	19-Sep-20	FY Results

Source: SharePad estimates, confirmed