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# SHARES

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AND MORE

# HIGH STREET BOOM OR BUST?

We look at the retail sector's winners and losers


**THE BIG VOTE**
Crunch time for Tesco's acquisition of Booker

**JUNIOR ISAS**
Little and often for a decent nest egg

**TIME TO BUY BONDS?**
Everything you need to know

***BUMPER EDITION:*** *FREE SPOTLIGHT REPORT INSIDE*

# High hopes for South Africa-focused stocks after president change

Ramaphosa's appointment has positive implications for many UK-listed shares

South Africa is the latest country to be closely watched by UK investors. A decent number of companies doing business in that part of the world have their shares traded on the London Stock Exchange.

Cyril Ramaphosa was last week sworn in as the new president of South Africa, replacing Jacob Zuma who stepped down after pressure from the governing ANC party amid corruption allegations. Ramaphosa wants to boost the economy and create jobs.

Reviving the country's economy would be positive for the likes of financial services groups **Investec (INVP)** and **Old Mutual (OML)**, both of whom have their shares traded in London.

Other London-listed stocks with South African operations include private healthcare group **Mediclinic (MDC)** and showers-to-bathroom accessories specialist **Norcros (NXR)**.

### ALL CHANGE FOR MINERS?

Perhaps the one sector really hoping for change is mining, of which there are many South African-focused constituents trading on the London Stock Exchange.

Ramaphosa was general-secretary of the National Union of Mineworkers in the 1980s and has previously been a director at platinum producer **Lonmin (LMI)**.

He's already called for a review of the latest mining charter in South Africa which last year came under fierce criticism by the mining industry.

The charter called for a new 1% royalty on turnover to go to local black communities, greater local community ownership rights and rules that mandate majority employment of black staff and procurement of services from black-owned businesses.

Critics said it would greatly push up costs in the mining industry, hurt already-wafer thin profit margins in the platinum sector and act as a deterrent to new investment.

A reworking of this charter could help to fuel shares in South Africa-focused miners on the UK stock market, including **Petra Diamonds (PDL)**, **Anglo American (AAL)** and **Tharisa (THS)**.

### WHAT HAPPENS NEXT?

'With Ramaphosa – a former union leader and subsequently a very successful and now wealthy businessman – leading the country, we expect to see a cleaning out of all those implicated and a restoration of the strength of institutions South Africa has always had,' says Oliver Bell, portfolio manager of the T.Rowe Price Middle East & Africa Equity fund.

Bell says the political developments come at a time when South Africa is at a cyclical economic bottom.

He believes the government needs to show commitment to fiscal consolidation. Bell reckons this could lead to a delay in the credit rating downgrade by Moody's and thus lead to interest rate cuts by the 'staunchly independent' central bank and reinforcing the 'positive virtuous circle'.

He adds: 'Positive macroeconomic figures may surprise in coming quarters – largely due to underestimated pent up demand and a restoration of confidence, which will then be reinforced by likely structural reforms from the new government.'

Liberum analyst Ben Davis last December said that Ramaphosa was the business-friendly choice in the ANC elective conference, saying a presidential victory for him could lead to a re-rating in equities.

However, Ramaphosa still has a considerable challenges ahead, so don't assume all South Africa-focused shares are an easy ticket to portfolio profits. You also have to consider that currency strength in the rand as a result of his election could work against miners who earn in US dollars. (DC)

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SENECA INVESTMENT MANAGERS

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- The Seneca Global Income and Growth Trust plc is designed for investors seeking a quarterly income with long-term capital growth and low volatility.
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**Find out more about Seneca Investment Managers at Senecaim.com or call us on 0151 906 2450**

## GROWTH, INCOME AND LOW VOLATILITY

- The Trust pays quarterly dividends, offering a current yield of circa 3.7%[1]. Over its last four financial years to April 2017 the Trust has grown its dividend at a compound rate of 4% per annum, ahead of CPI every year.*
- Over a typical investment cycle[2], we aim for the Trust to achieve a total return of at least CPI plus 6% after costs, with low volatility. In addition, we aim to grow aggregate dividends at least in line with inflation.
- Over the five years to end December 2017, the Trust delivered an NAV return of +67.3% with volatility close to half of the major equity indices[3]. Details of the Trust's returns can be found in the performance tables below.

| Cumulative performance (%) | 3 months | 6 months | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| Trust share price | 0.7 | 3.4 | 15.2 | 46.1 | 94.6 |
| Trust NAV | 1.1 | 4.8 | 14.4 | 38.8 | 67.3 |
| Benchmark | 2.3 | 4.5 | 6.3 | 14.0 | 22.2 |

| Discrete annual performance (%) | 31.12.2017 | 31.12.2016 | 31.12.2015 | 31.12.2014 | 31.12.2013 |
|---|---|---|---|---|---|
| Trust share price | 15.2 | 14.3 | 11.0 | 6.1 | 25.4 |
| Trust NAV | 14.4 | 12.5 | 7.8 | 2.7 | 17.4 |
| Benchmark | 6.3 | 3.6 | 3.6 | 3.6 | 3.5 |

## THINGS TO BE AWARE OF

[1]Current yield: the yield calculation is based on the latest quarterly dividend, annualised, compared against the month end share price.

[2]Seneca IM define a typical investment cycle as one which spans 5-10 years, and in which returns from various asset classes are generally in line with their very long term averages. There is no guarantee that a positive return will be achieved over this or any other period.

[3]Annualised volatility of returns over five years versus FTSE World ex-UK, FTSE UK Private Investor Balanced, AIC Flexible Investment Sector, FTSE All Share and Investment Association Mixed 40-85% shares.

*There is no guarantee that dividends will continue to increase or grow ahead of CPI.

Performance and dividend data sources: Seneca Investment Managers Ltd (SIML), Bloomberg & Morningstar. Share prices calculated on a total return basis with net dividends reinvested. NAV returns based on NAVs excluding income and with debt valued at par. Returns do not include current year revenue. Benchmark: LIBOR GBP 3 Months +3% to 06.07.17 thereafter CPI +6% after costs. Past performance should not be seen as an indication of future performance. The information in this article is as at 31.12.17 unless otherwise stated. The value of investments and any income from them will fluctuate, and investors may not get back the full amount invested.

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All calls are recorded. FP18/023

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## BROKER RATINGS EXPLAINED:

We use traffic light symbols in the magazine to illustrate broker views on stocks.

Green means buy, Orange means hold, Red means sell.

The numbers refer to how many different brokers have that rating.

Eg: 4 2 1 means four brokers have buy ratings, two brokers have hold ratings and one broker has a sell rating.

The traffic light system gives an illustration of market views but isn't always a fully comprehensive list of ratings as some banks/stockbrokers don't publicly release this information.

# Get ready for major changes to the FTSE 100 and FTSE 250 at next week's reshuffle

Royal Mail could take Hammerson's place in the FTSE 100 among a large number of potential changes across the leading UK market indices

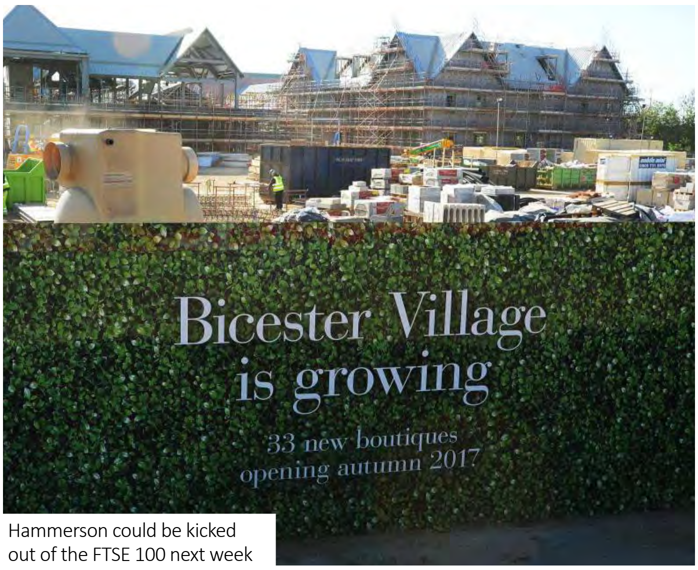
Shopping centre investor **Hammerson (HMSO)** could be booted out of the FTSE 100 index at next week's reshuffle and replaced by **Royal Mail (RMG)**, according to analysis of latest market values.

On the FTSE 250, relegation candidates include funeral services group **Dignity (DTY)**, pharmaceuticals expert **Vectura (VEC)** and real estate group **Hansteen (HSTN)**.

Recent stock market flotations **Contourglobal (GLO)**, which is a power generation business, and food manufacturer **Bakkavor (BAKK)** look almost certain to go into the FTSE 250 at the reshuffle, given they are both valued in excess of £1.1bn and larger than approximately 100 stocks already in the index.

## WHAT ARE THE RESHUFFLE RULES?

A FTSE 100 company can be removed from the blue chip index at the quarterly reshuffle if its market cap is lower than the tenth highest valued company in the FTSE 250.




Hammerson could be kicked out of the FTSE 100 next week

A FTSE 250 company will be promoted into the FTSE 100 at the quarterly review if it rises to 90th position or above, by market value.

## FTSE 100 POTENTIAL CHANGES

Hammerson's shares have been particularly weak so far in 2018, perhaps as investors digest its all-share takeover offer for rival **Intu Properties (INTU)** made in December last year.

Royal Mail looks set to return to the FTSE 100 after its share price enjoyed a strong rally amid a breakthrough over pay and pensions, plus a decent trading update on 1 February.

## FTSE 250 POTENTIAL CHANGES

Analysis by stockbroker Numis suggest quite a few names could enter the FTSE 250 at the reshuffle.

Promotions could potentially include private equity investor **Pantheon International (PIN)** and mortgage finance provider **Charter Court Financial Services (CCFS)** – which is one of *Shares*' top picks for 2018 – as well as fantasy toy seller **Games Workshop (GAW)** and investment trust **Baillie Gifford Japan (BGFD)**.

Potential demotions to the FTSE Small Cap index could include support services group **Mitie (MTO)**, retailer **N Brown (BWNG)** and transport operator **Go-Ahead Group (GOG)**.

The decisions for the FTSE review will be announced on Wednesday 28 February based on the previous day's closing prices. The changes will be effective on 19 March.

According to Numis, tracker funds which represent between 8% and 10% of the UK market are more impacted by companies leaving the FTSE All Share altogether than movement between its segments, being the FTSE 100, FTSE 250 and FTSE Small Cap indices. (DS)

# Four important stories from the past week: **HSBC**, **BHP Billiton**, **Acacia Mining** and **Fidessa**

We look at the latest news from four well-known stocks on the UK market

Investors may be disappointed with no annual dividend growth from FTSE 100 bank **HSBC (HSBA)** despite it reporting a stronger capital position.

The bank's common equity tier 1 ratio, a measure of the ability of the balance sheet to withstand economic shocks, has jumped to 14.5% from 13.6% a year ago.

HSBC has decided to maintain its dividend at $0.51 per share. That puts the shares at 729.4p on a 5% dividend yield. While HSBC's yield is still attractive, it is less generous than the 6% prospective yield from **Lloyds Banking (LLOY)**.

Shares in HSBC were weak after its 2017 results (published on 20 Feb) because its fourth quarter underlying pre-tax profit of $3.6bn was 8% below the consensus forecast.

## COULD IT BE DEMERGER #2 FOR BHP?

Diversified natural resources producer **BHP Billiton (BLT)** could get rid of its US shale oil and gas unit faster than previously expected. It says trade sale bids could be reviewed later this year.

It is also exploring potential asset swap opportunities and an exit via a demerger or IPO (initial public offering).

BHP demerged various coal and metal assets in May 2015 as a business now known as **South32 (S32)**. Shares in the separated company have risen by just over 50% since the BHP spin-off.

## WILL ACACIA SELL A STAKE IN ITS ASSETS?

Troubled gold producer **Acacia Mining (ACA)** has received interest from unnamed Chinese parties interested in making an investment at the asset level.

That's prompted Acacia to explore the value of selling a stake in some or all of its Tanzanian operations. Shares in the company have fallen 5% to 155.95p since the news, perhaps a reflection that the interest doesn't constitute a full takeover bid.

Acacia has struggled over the past year due to a ban in Tanzania on exporting unprocessed ore, hurting its sales and putting financial pressure on the business.

Outside of Tanzania, Acacia has exploration interests in Kenya, Burkina Faso and Mali.

## FIDESSA: BID WAR ON THE HORIZON?

Trading systems supplier **Fidessa (FDSA)** has received a surprise takeover offer from Swiss rival Temenos. That sent shares in the FTSE 250 constituent soaring by more than 20%.

The proposal is worth £36.467. It is structured as £35.67 per share for the business and the rest being Fidessa's recently-declared second half and special dividends.

While these events have sent Fidessa's stock soaring to unprecedented highs of £35.45, some observers believes there could be a bid battle for the company. Trade buyers FIS Global and Ion Investment Group look the likeliest candidates to also move on Fidessa. (DC/SF)

Shares in South32 have risen by more than 50% since its BHP Spin-off

# Why interest rates on deposit accounts could be set to rise

As a funding scheme for UK banks draws to a close, banks may need to offer more generous rates of interest

Banks have enjoyed access to cheap funding since the UK Government introduced the Term Funding Scheme in August 2016.

This allowed banks to borrow money close to the ultra low Bank of England interest rate.

With the scheme now drawing to a close, banks will be more reliant on customers' deposits to fund their activities and will therefore have to offer more generous rates for savers than before.

Among the best rates currently available, Atom Bank has a product which has a one-year fixed rate of 1.95% with a minimum deposit of just £50. Investec has a similar product with a rate of 1.9% although the minimum investment into this account is £25,000.

If banks are trying to lure investors into their savings accounts, they are likely to have to up their game.

Paul Richards, chairman of cash management provider Insignis Cash Solutions, says we 'could see a one-year term account reaching 3%' in the not too distant future.


This is still short of the dividend yield on the FTSE 100 which currently stands at 3.67%.

And by investing in equities you also potentially set yourself up for capital gains if the price of the share you are invested in goes up.

Though of course share prices can also fall, something which was highlighted during the global market sell-off earlier this month. (DS)

## Can airlines avoid a repeat of the recent ticket price war?

Dart Group's share price surge after ticket breakthrough may be short lived

DON'T GET over-excited by Jet2-owner **Dart (DTG:AIM)** saying it will 'materially' beat earnings expectations for the year to 31 March 2018 after an end to selling tickets with heavy discounts.

More important is the fact that Dart remains cautious on airline ticket prices. This echoes recent comments by sector peer **Ryanair (RYA)**. As such, share price strength in Dart could be short-lived until it can provide evidence that ticket prices aren't going to fall again.

The airline sector has been stuck in a vicious price war for some time, placing pressure on the industry and weeding out weaker competitors, including Monarch and Air Berlin.

Dart said on 19 February that it had seen a more normal pricing environment after the heavy discounting in the market over the past year. But the company remains cautious about the pricing outlook.

Earlier this month, Ryanair reported pricing would remain 'under pressure' and that it may not be able to push fares higher over the summer.

A lack of confidence in pushing up prices is a problem for the airline industry given recent oil price strength will eventually fed through into higher fuel prices. Airlines will need to find ways to pass on those extra costs to the customer. (LMJ)

# Crunch time as Tesco's acquisition of Booker goes to shareholder vote

Approval would create the UK's largest foods business

Shareholders in **Tesco (TSCO)** will next week (28 Feb) vote on whether Britain's biggest retailer should buy food wholesaler **Booker (BOK)**. Approval would create the UK's largest foods business.

The deal was unconditionally cleared by the Competition and Markets Authority (CMA) on 20 December 2017. It is now up to shareholders in both Tesco and Booker to approve the acquisition.

Under the terms of the takeover, Booker shareholders would receive 0.861 new Tesco shares and 42.6p in cash for each share they hold. Based on Tesco's 206.3p closing price on 1 February, the deal values Booker at £3.9bn or 220.2p per share.

## WHY IS IT SO SIGNIFICANT TO TESCO?

Dave Lewis-led Tesco, the UK's biggest grocer by market share, is a mature business. It claims the acquisition would provide shareholders with access to a larger and faster growing market opportunity for the enlarged business.

While the consumption-at-home market is significant and stable, the eating-out market continues to grow and evolve. Delivery and convenience are becoming increasingly important to business customers and consumers.

Bringing together the pair's retail and wholesale expertise would arguably mean Tesco is well positioned to offer a more innovative proposition to customers and consumers in a larger and faster growing market.

Taking Tesco into wholesaling and bringing the Londis, Budgens and Premier brands into the fold, the merger would position Tesco as a major supplier to the eating-out and convenience store markets.

These markets both offer superior growth prospects compared to the food-at-home market Tesco stores currently serve. As the largest UK food retailer, Tesco could also leverage its scale to cut costs, reinvest in pricing and become even more competitive.

Dave Lewis has been CEO of Tesco since September 2014

Tesco also claims the merger would improve the enlarged group's efficiency and yield at least £200m of annual synergies three years after completion.

Booker's strong cash flow is seen to be another key attraction, as it would boost the dividend-paying capacity of Tesco.

As for Booker, it tells shareholders that by being subsumed into the enlarged Tesco, it would be able to further improve choice, prices and service to its retail, catering and small business customers.

## WHY ARE SOME SHAREHOLDERS OPPOSED?

Two major Tesco shareholders (Schroders and Artisan) last year questioned the merits of the tie-up and may not vote in favour of the deal.

There are concerns such a large transaction could derail Tesco's recovery under Lewis at a time of changing shopping habits, fierce levels of industry competition from rivals including Aldi and Lidl and Amazon, and with consumer budgets also stretched.

Other commentators argue the price being paid for Booker looks full and the deal would add unwanted levels of complexity to what is proving to be a successful Tesco turnaround.

As for Booker shareholders, US hedge fund Sandell Asset Management recently said it would oppose the takeover bid unless Tesco made a better offer. (JC)

# BIGGEST TAXI FARE EVER: UBER'S $4.5BN LOSS

UBER'S FULL YEAR results show the ride-hailing company's losses jumped by 61% in 2017.

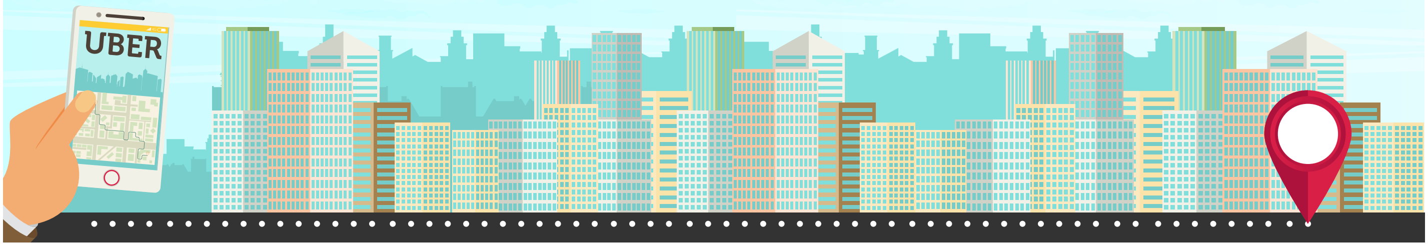
The company ran-up staggering losses of $4.5bn last year, up from $2.8bn in 2016, according to various media reports. In the last quarter alone Uber apparently ate through $40m of cash as it invests in expansion.

'There are few historical precedents for the scale of its loss,' wrote Bloomberg.

Uber is privately owned so is not required to publicly report its financial results, but the company has begun disclosing some figures in recent months.

This is believed to be part of a planned shift to become more transparent ahead of a mooted IPO in New York, perhaps later this year.

Soaring losses may see those IPO hopes stuck in traffic for a while yet.




# ALERT LEAVES LAURA ASHLEY FIRMLY OUT OF FASHION

SHARES IN WALLPAPER, furniture, fashion accessories and bed linen brand **Laura Ashley (ALY)** have fallen by 83% since the summer of 2015.

The share price now trades at 6p following the retailer's latest profit warning (15 Feb), an alert combined with poor half year results to 31 December.

Amid a consumer spending squeeze, pre-tax profit reduced to £4.3m (2016: £7.8m) on sales of £134.7m (2016: £146m). Profit margins were squeezed by sterling weakness versus the US dollar.

# 24%

## Ricardo shifts up a gear with electric vehicle work

THERE'S BEEN AN impressive change of fortunes for engineering and environmental consultancy **Ricardo (RCDO)** with a record order book worth in excess of £290m at the end of 2017.

Encouragingly, much of this new business is stemming from battery developments and the wider shift to electric vehicles.

Order intake for electric or hybrid vehicles in the second half of 2017 represented 24% of total order intake. That's a significant step up from the 17% figure for the year to 30 June 2017.

Half year results on 28 February will give Ricardo another chance to convince investors that it is no longer solely focused on combustion engines.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# Now is the perfect time to buy shares in Tracsis

Small cap issues reassuring trading update

**TRACSIS ↗ BUY**
(TRCS:AIM) 515p
Stop loss: 412p

Market value: £144m

We've been quietly watching **Tracsis (TRCS:AIM)** over the past few weeks looking for the right entry point for investors. We believe we have now found one.

Tracsis is a Leeds-based smart transport analytics and infrastructure technology company that *Shares* has followed closely since 2013. Back then the stock was changing hands for 164.5p yet even after rallying 200%-plus in five years we still see the investment story as compelling.

This week's first half trading update sent a positive message. It should put to bed any lingering doubts of a prolonged hangover from last year's early growth worries.

Half year revenues will top £18m and deliver earnings before interest, tax, depreciation and amortisation (EBITDA) of £4.3m. It means equivalent growth over last year of 15% and 23% respectively, and builds on what was a very firm end to the previous 12 months.

## SMOOTHER, FASTER, BETTER TRANSPORT

Effectively, Tracsis provides the technology tools to help Network Rail and train operators improve performance, cut capacity problems and keep services running. It also provides technology-led insights on pedestrian and road traffic for infrastructure planning or organising large and complex events.

Acquisitions have always acted as an important growth lever for Tracsis. A net cash position of £18.5m puts the company in a strong position to take advantage of opportunities that come its way.

Acquisitions worry some investors but Tracsis has an excellent record, in both paying the right price for the right businesses and integrating them.

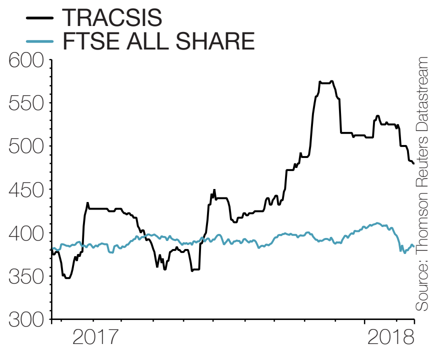
In the past five or so years it has bedded in eight acquisitions successfully. Importantly, deals are always struck using funds generated by the company, while only small amounts of new shares are issued to provide incoming managers with attractive incentives for future success. That means Tracsis shareholders face little or no dilution.

We wouldn't be surprised to see one or two meaningful deals sealed by year end, adding to the small purchase of a couple of passenger compensation operators at the start of February.

On a consensus-based price to earnings (PE) multiple of 22 the stock may not look cheap. But the company deserves a premium rating given a superb track record.

Investec believes there is potential for earnings per share in the financial year to July 2019 to be 'materially' higher than currently forecast, based on organic upgrade potential and further M&A. (SF)

**BROKER SAYS: 1 0 0**



# Diversified Gas & Oil becomes top AIM producer

Recent deals represent an acceleration of the firm's acquisition strategy

Oil and gas firm **Diversified Gas & Oil's (DGOC:AIM)** buy-and-build strategy in the US Appalachian basin is gathering pace following a big fundraise and two sizeable acquisitions which are set to make it the biggest producer on AIM.

Crucially this is a story with strong returns on capital and generous dividends at its heart, making the company something of an outlier in the oil and gas sector.

The company has a policy of returning 40% of its operating cash flow to shareholders. It is set to yield between 5.5% and 6% once the latest deals complete, based on forecasts from banking group Mirabaud.

The enlarged company will have $70m to $75m annualised earnings (+150% on previous run-rate), adds Mirabaud.

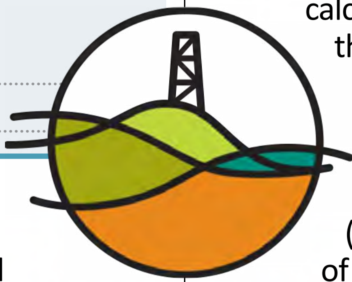
### WHAT HAS IT BOUGHT?

Its strategy is to buy conventional assets, typically from larger operators which are not set up to run them as efficiently and are often chasing the higher volumes associated with unconventional assets.

Diversified's wells often have long lives and low rates of decline with minimal maintenance costs. Its output is heavily weighted towards natural gas.

The most recent acquisitions – and the accompanying $189m placing at 80p to fund them – received shareholder approval on 19 February. The transactions are expected to complete in March.

**DIVERSIFIED GAS & OIL**
**BUY**
(DGOC:AIM) 90p
Stop loss: 60p
Market value: £280m



Production is set to increase from 10,000 barrels of oil equivalent per day (boepd) to 28,000 boepd and proven, developed and producing reserves will more than double to 173m barrels of oil equivalent.

The acquired portfolios of assets are of a similar size. Small private conventional outfit Alliance Petroleum was bought outright for $95m and non-core wells were picked up from CNX Gas for $85m. Both are located close to Diversified's existing assets in the Appalachian.

### PROSPECTS FOR FUTURE DEALS

With a larger production base, the company has been able to refinance its borrowings on much more advantageous terms, reducing levels of interest from 8.5% to between 2.5% to 3.25%.

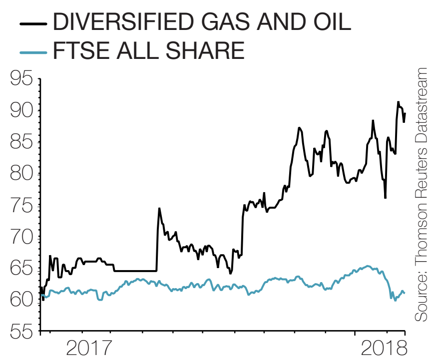
This suggests further M&A can be completed using debt and without diluting existing shareholders.

Mirabaud comments: 'Our back of the envelope calculation suggests the company could comfortably execute around $120m of future deals at four times earnings (adding around $30m of earnings) whilst keeping its gearing (debt) ratio the right side of two times.'

Significantly, the business is generating plenty of profit and cash flow despite depressed natural gas prices in the US. According to chief executive and founder Rusty Hutson Jr the business could be profitable at gas prices upwards of $1.20 per million cubic feet (mcf) against current levels of around $2.60 per mcf.

Any recovery in prices as, for example, industrial users switch out of coal and US exports of liquefied natural gas (LNG) ramp up, could see Diversified's earnings and dividend expectations upgraded. (TS)

**BROKER SAYS: 1 0 0**



# RECKITT BENCKISER

(RB.) £59.08

## Loss to date: 16%

**Original entry point:**

**Buy at £70.37,** 12 October 2017

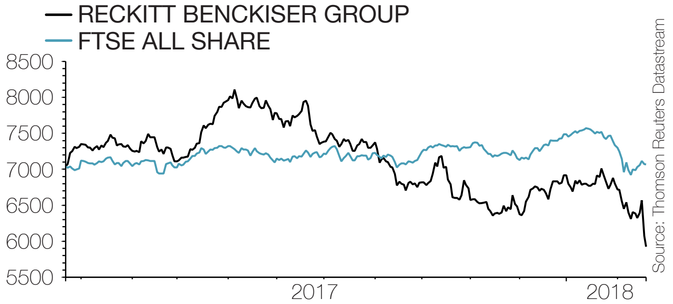
OUR BULLISH CALL on consumer health and hygiene titan **Reckitt Benckiser (RB.)** is a disappointing 16% in the red. The shares have fallen despite full year results (19 Feb) revealing a return to sales growth in the fourth quarter, boosted by a strong start to the flu season, as well as a 7% hike in the total dividend to 164.3p.

Investors were disappointed as the *Durex*, *Strepsils* and *Air Wick* brands owner missed 2017 profit estimates and issued vague guidance for 'moderate' medium-term operating margin expansion.

In 2018, the £42.7bn cap is targeting 13% to 14% total sales growth thanks to the acquisition of US baby formula maker Mead Johnson, yet tepid 2% to 3% like-for-like growth looks on the cards amid tough market conditions.

Uncertainty regarding the magnitude and financing of mergers & acquisitions is also weighing on the shares; Reckitt could become involved in an auction for Pfizer's consumer healthcare operations, which are up for sale.

Though market conditions are challenging, we remain fans of Reckitt's brand strength and consistent dividend growth and note Liberum Capital's £80 price target, one implying a healthy 35.4% upside.




**SHARES SAYS:** ↗

**Reckitt Benckiser's 2017 performance and share price chart are disappointments to us, yet we're sticking with the company for its focus on higher margin health and hygiene categories and growth potential in emerging markets. (JC)**

**BROKER SAYS:** 12 8 2

# GALLIFORD TRY

(GFRD) 878p

## Loss to date: 20% (stopped out)

**Original entry point:**

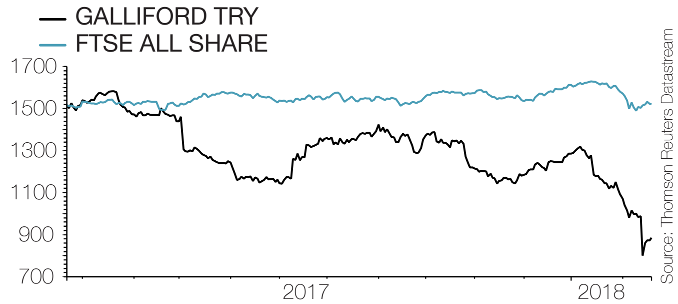
**Buy at £11.51,** 30 November 2017

CONSTRUCTION, REGENERATION AND housebuilding company **Galliford Try (GFRD)** falls out of our *Great Ideas* portfolio after share price weakness triggered our stop loss.

The market didn't like news of a £150m fundraising which is associated with needing money to finish a project carried out in partnership with failed construction firm Carillion and **Balfour Beatty (BBY)** in Aberdeen.

The company says it could have absorbed the extra costs without having to issue new shares but it didn't want to divert resources away from its better performing regeneration and housebuilding divisions.

Liberum analyst Charlie Campbell says the capital raise 'is neither a signal of a worsening outcome on the Aberdeen road nor a sign of urgent need; rather we see this giving the group a balance sheet more appropriate for its activities and growth prospects'.




**SHARES SAYS:** ↗

**In the long-term this capital raise might be viewed more positively. We remain fans of the business, despite our Great Idea trade having come to an end. (TS)**

**BROKER SAYS:** 4 2 0

# What has gone wrong at Merlin Entertainments?

We explain the issues depressing shares in the theme park operator and what it can do to get growth back on track

It has been a volatile ride for investors in **Merlin Entertainments (MERL)** of late as terrorism concerns, business criticisms and weather issues dampened sentiment towards the company's shares. The damage to the share price has been extensive and the company was booted out of the FTSE 100 in December 2017.

We now look at Merlin in more detail ahead of its full year results on 1 March and after activist fund ValueAct Capital took a 5.4% stake in the company, prompting speculation Merlin could be broken up.

## WHAT'S HAPPENED?

One third of Merlin's market value has been wiped off since June 2017.

Having peaked at 537p last summer, it now trades at 353.2p which is not far off the 315p price at which it joined the stock market in November 2013.

Merlin comprises three key divisions: Midway Attractions, Resort Theme Parks and Legoland. In Midway, investors will be familiar with some of the big names in its portfolio such as Madame Tussauds, London Eye and The Dungeons.

The company operates popular theme parks Alton Towers, Thorpe Park and Chessington World of Adventures, as well as family friendly destination Legoland.

Terrorism concerns have deterred many visitors, particularly over the last year. Merlin says there was an immediate drop-off in domestic visitation to London following the Westminster Bridge attack in April and demand fell further following other attacks.

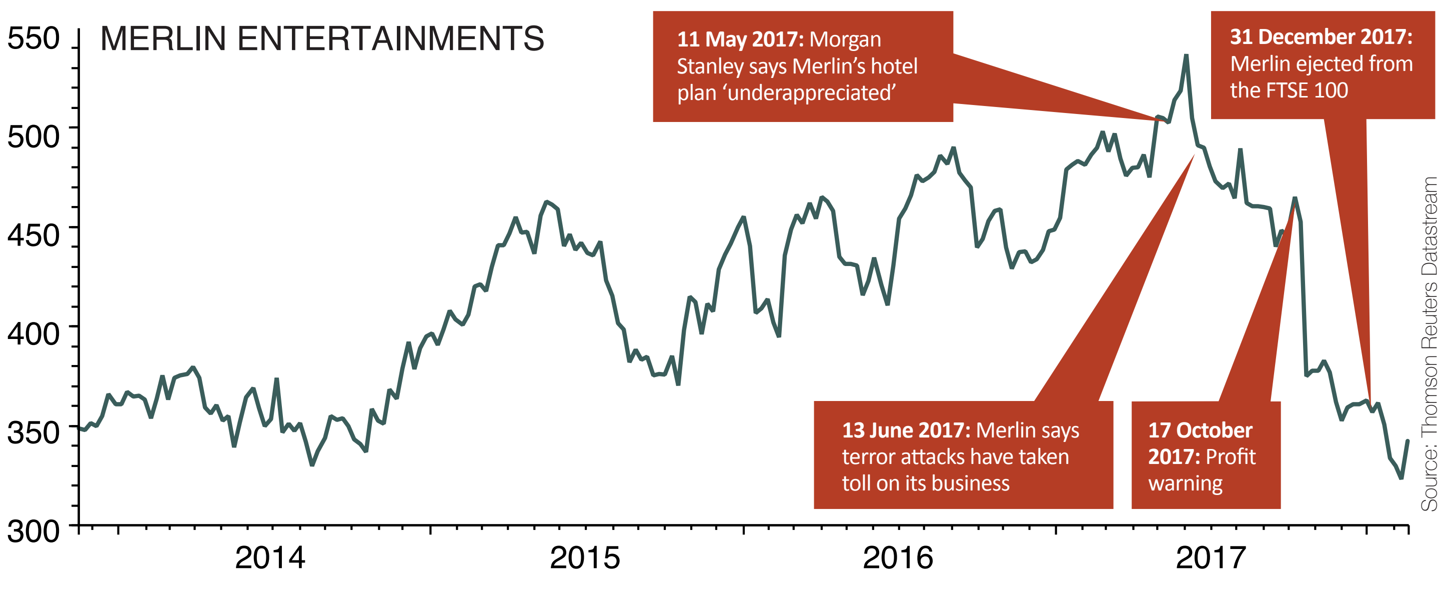
Many of Merlin's attractions are based a short journey from London or in the capital itself. Wet weather in Northern Europe, Italy and Florida also kept many visitors away over the peak summer period from some of its attractions.

In October, these negative issues came to a head, forcing Merlin to downgrade 2017 earnings expectations by 3% to between £470m and £480m as like-for-like growth slowed in the 40 weeks to 7 October to 0.3%.

## ANALYST CONCERNS

The theme park operator's underwhelming performance has brought out critics within the analyst community.

One of the detractors is Berenberg's Owen Shirley who flagged in March 2017



that Merlin had failed to take advantage of more UK visitors, while noting Midway like-for-like growth has been on a 'downward trajectory' since 2010.

Hurricane Irma last year didn't help matters by forcing Legoland Florida to close for three days and putting off visitors in the aftermath. Like-for-like growth of 3.5% at Legoland in the 40 weeks to 7 October was half the level originally forecast by Shirley at Berenberg.

'Looking forwards, 2018 is likely to be worse, with no Lego movies to prop up elevated levels of performance and the sales of the Lego toy brand itself declining for the first time in a decade,' commented Shirley in October.

The analyst cut his earnings forecasts following the trading update arguing the longevity of operational weakness suggests pricing and competition are additional risks.

Earnings per share (EPS) estimates were downgraded by 6% for 2017 to 20p and reduced by 10% to 20.9p the year after. Forecasts for EPS were also cut by 13% in 2019 to 22p.

### MERLIN ENJOYS SOME INHERENT STRENGTHS

Despite the negative isues, it is worth remembering that Merlin benefits from strong brands and generates approximately two thirds of earnings overseas and so enjoys geographical diversification.

Approximately half of its sales are generated from Continental Europe and North America, and the remaining 14% comes from Asia Pacific.

Merlin plans to take advantage of its global reach by opening 40 Midway attractions, 2,000 rooms across its portfolio and four Legoland parks by 2020.


It is forecast to spend £700m over the next three years to generate long-term value in its highest returning divisions, Legoland and Resort Theme Parks accommodation, according to stockbroker Numis.

Pre-tax profit is anticipated to be flat at £277.5m in the year to 31 December 2017, but rise to £290.2m in 2018 and £320m in 2019 according to Reuters.

Shares in Merlin are trading at a forecast 16.1 times earnings per share for the year to 31 December 2018.

While others may view the relatively modest valuation as a reflection of challenged business, some analysts believe this represents a buying opportunity.

Numis analyst Tim Barratt anticipates Merlin will beat the bottom end of its downgraded earnings guidance when it reports full year results on 1 March.

In the US, a strong performance is expected thanks to a positive read across from Disney's encouraging performance in its theme parks.

### 'UNDERAPPRECIATED' HOTELS GROWTH

Investors may also be overlooking value in Merlin's plans to expand its hotel offering. Investment bank Morgan Stanley previously argued the company's strategy to add themed hotels to its parks was 'underappreciated' in both profitability and scale.

In April 2017, analyst Jamie Rollo said hotels could comprise 30% of earnings if Merlin kept up its accelerated expansion and opened 7,000 rooms by 2022.

Rollo's analysis implied the theme park operator could generate £340 revenue per room per night – three to four times higher than the market average.

'Themed hotels provide an immersive experience for families and premium revenues to standard hotels offerings,' commented the analyst. (LMJ)

## FRIDAY 23 FEBRUARY

| FINALS | |
|---|---|
| International Consolidated Airlines | IAG |
| Pearson | PSON |
| Royal Bank of Scotland | RBS |
| Rightmove | RMV |
| Standard Life Aberdeen | SLA |
| William Hill | WMH |

## MONDAY 26 FEBRUARY

| FINALS | |
|---|---|
| Ascential | ASCL |
| Bunzl | BNZL |
| Dialight | DIA |
| Hammerson | HMSO |
| Keller | KLR |
| Quartix | QTX |
| RTC | RTC |
| Senior | SNR |
| **INTERIMS** | |
| Avation | AVAP |
| Dechra Pharmaceuticals | DPH |
| Sylvania Platinum | SLP |
| Town Centre Securities | TOWN |
| **TRADING STATEMENTS** | |
| Associated British Food | ABF |
| **FINALS** | |
| Bank of Cyprus | BOCH |
| Coats | COA |
| Croda | CRDA |
| Dalata Hotels | DAL |
| Direct Line | DLG |
| Derwent London | DLN |
| Drax | DRX |
| Elementis | ELM |
| FBD | FBH |
| Fresnillo | FRES |
| James Fisher & Sons | FSJ |
| GKN | GKN |
| Greggs | GRG |
| Inchcape | INCH |
| Johnson Service | JSG |
| Jupiter Fund Management | JUP |
| Morgan Advanced Materials | MGAM |
| Meggitt | MGGT |
| Provident Financial | PFG |
| Persimmon | PSN |
| Standard Chartered | STAN |
| **INTERIMS** | |
| Bluefield Solar Income Fund | BSIF |
| Clinigen | CLIN |
| DotDigital | DOTD |
| Swallowfield | SWL |

## WEDNESDAY 28 FEBRUARY

| FINALS | |
|---|---|
| Admiral | ADM |
| Bakkavor | BAKK |
| Man Group | EMG |
| Foxtons | FOXT |
| Informa | INF |
| ITV | ITV |
| Jardine Lloyd Thompson | JLT |
| Provident Financial | PFG |
| St James's Place | STX |
| Travis Perkins | TPK |
| Tarsus | TRS |
| Taylor Wimpey | TW. |
| UBM | UBM |
| Weir | WEIR |
| **INTERIMS** | |
| Avingtrans | AVG |
| Genus | GNS |
| Ricardo | RCDO |

**THE KEY FOCUS in free-to-air broadcaster ITV's (ITV) full year results on 28 February is likely to be on TV advertising which is still the biggest contributor to the company's revenue.**

**It previously guided for a 5% annual decline.**

**ELEMENTIS' (ELM) FULL year results on 27 February will show just over nine months' contribution from SummitReheis whose acquisition completed on 24 March 2017.**

**The chemicals group paid $360m to acquire ingredients manufacturer SummitReheis to bolster its existing personal care arm. At the time of the deal Elementis said the acquisition would deliver material earnings accretion and substantial free cash flow accretion in the 2017 financial year.**

## THURSDAY 1 MARCH

| FINALS | |
|---|---|
| Allied Irish Banks | ALBK |
| Arrow Global | ARW |
| BBA Aviation | BBA |
| Bovis Homes | BVS |
| Cobham | COB |
| Costain | COST |
| Capita | CPI |
| Evraz | EVR |
| Grafton | GFTU |
| Gresham House | GHE |
| Hastings | HSTG |
| Hunting | HTG |
| Howden Joinery | HWDN |
| IndigoVision | IND |
| International Personal Finance | IPF |
| Laird | LRD |
| Merlin Entertainments | MERL |
| Mondi | MNDI |
| National Express | NEX |
| Nichols | NICL |
| RPS | RPS |
| Rentokil | RTO |
| Schroders | SDR |
| Synthomer | SYNT |
| Vesuvius | VSVS |
| WPP | WPP |
| XP Power | XPP |
| **INTERIMS** | |
| Haydale Graphene | HAYD |
| Redde | REDD |
| **ECONOMICS** | |
| **UK** | |
| Manufacturing PMI | |
| Mortgage Approvals | |

| EX-DIVIDEND | | |
|---|---|---|
| Alumasc | ALU | 2.95p |
| Arden Partners | ARDN | 1p |
| Beazley | BEZ | 7.4p |
| Colefax | CFX | 2.4p |
| City of London | CLIG | 9p |
| EasyJet | EZJ | 40.9p |
| Ideagen | IDEA | 0.078p |
| Lakehouse | LAKE | 0.5p |
| Murray Income Trust | MUT | 8p |
| Park Group | PKG | 1p |
| Rio Tinto | RIO | 129.43p |
| Standard Life UK Smaller Companies Trust | SLSC | 1.75p |
| Sanderson | SND | 1.55p |
| Witan Investment Trust | WTAN | 6.75p |
| WYG | WYG | 0.6p |

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# HIGH STREET BOOM OR BUST?

## We look at the retail sector's winners and losers

Structural shifts in retail are accelerating as we change the way we shop. The sector's constituents also find themselves at a crossroads at a time when consumer budgets are under pressure.

Weak consumer spending remains a headwind for retailers. The volume of retail sales grew 0.1% month-on-month in January 2018 according to the Office for National Statistics, below analysts' forecasts, with cautious, cash-strapped shoppers keeping a lid on spending.

For much of 2017, retail sales held up better than expected, but the squeeze on spending created by high inflation and a weakened pound eventually dribbled down to the high street.

Citing analysis from Deloitte, investment bank Liberum Capital says the number of retailers that entered into administration rose by 28% in 2017 to 118, up from 92 in 2016.

'This rise marks the first increase in the number of retail insolvencies in five years, and was exacerbated by a 55% jump in the number of administrations by those with more than 10 stores, including Jager, Brantano, Jones Bootmaker and Multiyork,' comments Liberum.

**BETTER OUTLOOK FOR RETAIL?**

Consumer spending has been hampered by prices rising faster than wages, with the fall in the pound following the EU referendum leading to rising inflation.

Yet the good news for the nation's hard-pressed shopkeepers is the Bank of England expects the consumer squeeze to ease in 2018 – imported price inflation should begin to fade as the effects of sterling's devaluation annualise out – and wage growth ticks higher.

The Bank of England has also raised its UK growth forecast for 2018 from 1.5% to 1.7%. That is supportive for confidence in the wider economy.

Inflation remains stubbornly high for now though. The latest UK consumer price index (CPI) reading of 3%, ahead of forecasts for 2.9%, reinforced concerns that interest rates will rise sooner and higher, putting additional pressure on consumers, many of whose finances are already stretched.

**WHICH RETAILERS ARE FLOURISHING?**

January's blizzard of retail Christmas updates highlighted weak footfall dynamics being offset by strong online sales, continuing the trend of recent years.

'What we are seeing is that the disparity between the "new-world" retailers versus the more traditional, mid-market players, where the consumer proposition and service elements are not compelling or agile enough, is widening,' says Liberum.

'Online is not a silver bullet for everyone and while, in general, management teams may be strong, the foresight to invest in the right systems, sell fashionable brands and have a clear market presence is central to ongoing success, in our view.'

Stockbroker Numis Securities says fortunes were mixed through the Christmas period. 'There was the biggest gap between winners and losers that we can remember in recent years, but with downgrades/profit warnings more frequent than upgrades.'

Overall we'd suggest that the retail sector continues to have attractive investment opportunities, but the gap between the winners and losers is getting much bigger.

You need to think about brand relevance, whether there has been any recent investment in stores or websites, customer service standards, quality of goods and leadership. You can't simply say all online companies are good investments and all high street ones are bad. We see good and bad players in both of these channels.

Read on and we'll explain who's hot and who's not in the retail sector.

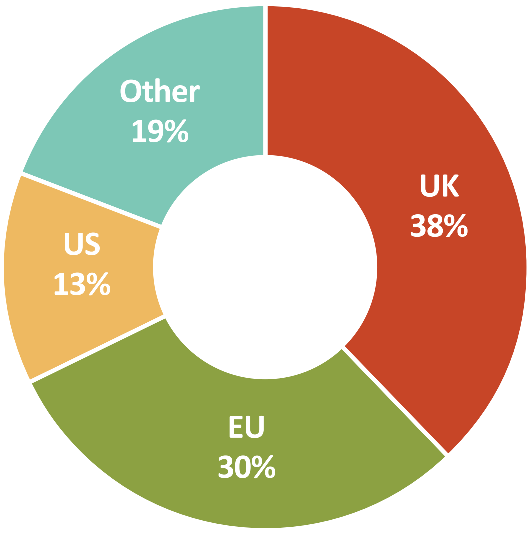
## ASOS LEADS THE WAY

Christmas is one of the most important trading periods for retailers. We've now had updates from all of the major UK-quoted retailers and can get a sense for how the next set of financial results may play out.

Festive winners included the pure-play online retailers which have structural advantages (no costly stores) and global growth potential.

**ASOS (ASC:AIM)** achieved 30% increase in retail sales in the last four months of 2017 to £790.4m. Nearly two third (62%) of those sales were generated from outside of the UK.

**ASOS: Geographical sales spread**




Source: ASOS. Based on sales in 4 months to 31 Dec 2017

Focused on the 20-something demographic, ASOS's US sales shot up 24% to £102.4m, EU sales skipped 42% higher to £235.2m and rest of the world revenues rocketed 34% north to £151.9m in the four-month period.

The period's strong performance was supported by an outstanding showing from the UK. ASOS highlighted an acceleration in sales 'in a challenging market', with retail sales shooting 23% higher to £300.9m.

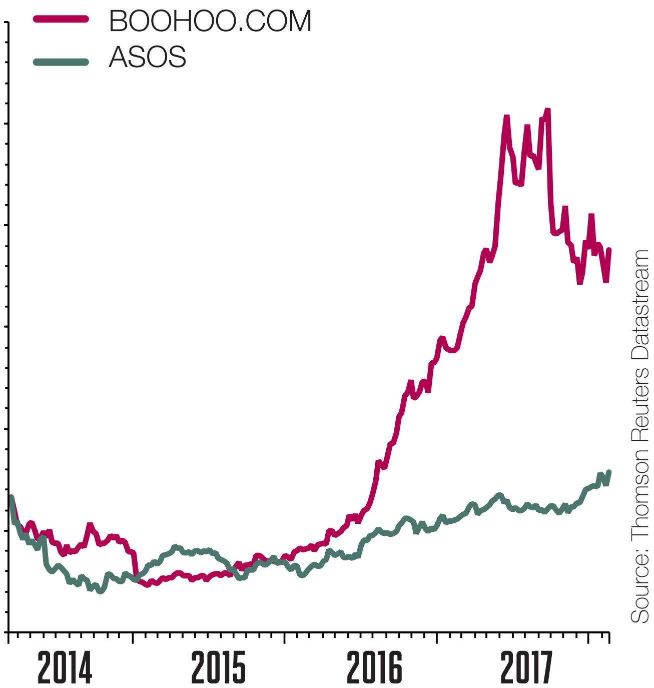
Significantly, as it demonstrates a business happy to invest for the future, CEO Nick Beighton said the customer proposition was further enhanced in the UK following the launch of *Try Before You Buy* and *ASOS Instant*, its same day delivery proposition.

Retail winners with a high street/physical store presence include **JD Sports Fashion (JD.)**, the sportswear-to-outdoor brands business riding the 'athleisure' boom. It positive sales momentum carried over into Christmas, triggering another upgrade to earnings guidance.

## BOOHOO IS GROWING FAST

Also strutting its stuff over the peak selling period was smaller online fashion peer **Boohoo.com (BOO:AIM)**, sales doubling to £228.2m in the four months to 31 December as all brands – *Boohoo*, *PrettyLittleThing*, *Nasty Gal* – generated record revenues.

Drawing confidence from its festive showing, Boohoo also upgraded current year sales growth guidance yet again, from 80% to around 90%.




## THE CONTRARIAN'S VIEW – WHY ONE FUND MANAGER BELIEVES THE RETAIL SECTOR OFFERS GOOD INVESTMENT OPPORTUNITIES

ALASDAIR MCKINNON, fund manager of **The Scottish Investment Trust (SCIN)**, believes the UK high street presents a happy hunting ground for contrarian investors.

'The issues facing the sector are well known but there is a lot to love about some of these unfashionable stocks. People often get caught up in the latest trend and that makes it hard to see that world domination is not the only possible outcome.

'The so-called "Amazonification" of the world is an excellent example and investors are prematurely foretelling the demise of physical shops. Ultimately, physical shops are here to stay. Shoppers like to see and feel products, they like to socialise while they shop and they enjoy the experience of shopping. Retailers need to adapt to changing habits and we believe those with strong brands are best placed to do so.'

McKinnon says physical stores can be a competitive advantage because they allow for convenient collections and returns.

He believes there is a lot of pessimism surrounding the retail sector and that creates potential to defy gloomy expectations. McKinnon says **Marks & Spencer (MKS)** is a great example of an 'ugly duckling' on the high street.

'It has a strong brand and a compelling turnaround plan that is backed by excellent leadership. Traditional retailers have one thing that online competitors often don't and that is profits. That allows for attractive dividends to be paid to shareholders.

'The depressed valuations on offer conceal compelling opportunities. It is not always possible to say when sentiment will improve but a strong dividend yield rewards you for your patience. That is the case with M&S which has a sustainable dividend yield of over 6%,' he adds.

ASOS's shares are currently trading at an all-time high of £75.68. In contrast, Boohoo.com's shares have been struggling since September 2017 when its joint CEO Carol Kane sold £10.7m worth of stock and the company reported a slight fall in margins.

## WHICH SHOPKEEPERS ARE STRUGGLING?

BHS has gone (from the high street), House of Fraser is in dire straits and both Marks & Spencer and **Debenhams (DEB)** are shuttering stores, so few would deny the department store model is structurally challenged. Indeed, if no department stores existed today, would anyone feel the need to invent them?

Ailing Debenhams issued a profit warning in January after a terrible Christmas for the business. We think the fact the hard-pressed British brand is locked into very long-term leases will hinder CEO Sergio Bucher's attempts to turn round Debenhams.

Liberum downgraded its full year pre-tax profit estimate by a whopping 35% to £52.1m following the sobering festive showing.

Post-Christmas profit warnings were also issued by children's goods retailer **Mothercare (MTC)** and flooring chain **Carpetright (CPR)**.

Meanwhile, high street doyen Marks & Spencer's clothing, home and food like-for-like sales weakened in its third quarter period to 30 December 2017. The British retail institution also reported a significant year-on-year slowing of sales via M&S.com.

Suffice to say; the success of its turnaround strategy under veteran chief executive Steve Rowe and backed by chairman Archie Norman remains quite uncertain. Marks & Spencer's full year results will be published on 23 May.


## MAKING A COMEBACK?

TVs-to-mobile phones purveyor **Dixons Carphone (DC.)** said like-for-like sales grew 6% in the 10 weeks to 6 January 2018, buoyed by strong performances in the Nordics and Greece, while UK & Ireland like-for-likes were up by 3%.

One disappointment was the top end of the full year pre-tax profit guidance being downgraded to a £365m-to-£385m range from £360m-to-£400m previously. However, the appointment of Shop Direct boss and digital expert Alex Baldock as Dixons Carphone's new CEO is very welcome.

Mobile phones are the weak part of Dixons, so Baldock needs to look at that part of the business quickly. He also needs to assess the size of the company's physical store estate. There are growing expectations he will close many stores.


### SUPERMARKETS – STRONG FOOD SALES

ACCORDING TO THE LATEST BRC-KPMG Retail Sales Monitor, total retail sales in the UK rose 1.4% in January 2018 versus 0.1% growth in January 2017, with food sales outperforming non-food.

With shoppers ring-fencing spend on celebratory festive food and drink, **WM Morrison Supermarkets (MRW)** proved a Christmas winner, like-for-like sales surging 3.7% higher in the six weeks to 7 January 2018.

**Tesco's (TSCO)** UK & Ireland like-for-likes grew 2.3% in the so-called 'golden quarter' while rival **Sainsbury's (SBRY)** enjoyed a strong Christmas week too. Tesco will report its full year results on 11 April; followed by Sainsbury's on 2 May.

## THE VALUE END OF THE MARKET

Investors have been hungry for exposure to the growth story on offer at **B&M European Value Retail (BME)**, the multi-price discounter and beneficiary of the cash-strapped shopper's quest for value.

B&M is among those shopkeepers targeting the value end of the market, appealing to hard-pressed consumers. It is a self-funded growth story and a cash generative business offering scope for higher dividends in time.

New customers are driving strong growth at B&M. It is opening new stores in the UK and Germany and the acquisition of Heron Foods provides a new growth channel in the attractive convenience sector.

Other quoted plays on value, one of the sector's structural growth themes, include **Associated British Foods' (ABF)** Primark fashion chain, which achieved record sales in the weeks before Christmas.

Womenswear purveyor **Bonmarche (BON)** and budget footwear retailer **Shoe Zone (SHOE:AIM)** are also among the value-orientated retailers on the stock market.


## WHO COULD THRIVE IN 2018?

In our view, those retailers with strong, differentiated brands, distinct market positions and the well-invested infrastructure to power online sales, are those best placed in this challenged retail environment.

Over-spaced retailers with weaker brands facing tougher competition in crowded markets are best avoided.

Online transactions are here to stay, but investors shouldn't underestimate the staying power of shops.

Shopping is a major leisure activity for a great number of people – not just a necessity, but a social activity, even a hobby and the convenience of clicks can't always compete with that.

Meanwhile, many bricks-and-mortar retailers are meeting the e-commerce challenge head on, by creating multi-channel offerings with mobile apps and 'click and collect'.

There are some very exciting growth stories in the wider retail space although investors will have to pay up in order to gain access to their soaring sales and growing cash flows.

For instance, e-commerce and international expansion are powering sales and profit growth at quirky British lifestyle brand **Ted Baker (TED)** and at Cheltenham-based **Superdry (SDRY)**.

Fast fashion womenswear brand **Quiz (QUIZ:AIM)** has positive momentum at its heels and awareness of the brand is growing, supporting omni-channel growth that includes opening new physical stores.

And last but not least, **Joules (JOUL:AIM)** has the kind of brand differentiation that provides insulation from the headwinds facing the sector and is firmly in an earnings upgrades cycle.

# OUR TOP FIVE STOCKS TO PLAY THE RETAIL SECTOR

### BEST-IN-CLASS RETAILER
## NEXT

Investors should buy cash-generative clothing-to-homewares retailer **Next (NXT)** at £49.66.

It has best-in-class management and strong cash returns pedigree. Despite recently being cautious on the outlook, Simon Wolfson-led Next has committed to spend another £300m on earnings enhancing share buybacks in the current financial year to January 2019.

Any further strengthening of the pound will provide a boon for Next's margins, while the Bank of England's upgrade to UK economic forecasts and bullish view on wages implies a more positive backdrop for the retailer.


### GREAT WAY TO PLAY THE VALUE SECTOR
## B&M

Liverpool-headquartered B&M was founded in 1978 and floated on the stock market in 2014. It now has more than 540 stores and has considerable buying power, enabling it to sell goods at low prices. It also owns JA Woll, a chain of over 80 discount variety stores in Germany. Buy at 432.2p


### HIGH STREET WINNER
## JD SPORTS FASHION

Established in 1981, JD Sports has proved to be one of the most successful retailers on the high street. It has more than 1,200 stores in the UK and Europe, using a range of brands including *JD*, *Size?*, *Kooga* and *Nicholas Deakins*.

Pre-tax profit before one-off items grew by 56% in 2017 to £244.8m. It ended the period with £213.6m net cash. Buy at 385.9p.


### GLOBAL ONLINE CHAMPION
## ASOS

This stock is a great way to play growth in e-commerce. Asos sells more than 80,000 branded and own-brand products, delivering from fulfilment centres in the UK, US, Europe and China to almost every country in the world.

The shares always trade on a very high valuation, yet the business keeps delivering strong earnings. Buy at £75.66.

### CONTRARIAN PICK
## DIXONS CARPHONE

This is the highest risk of our five retail selections. We're confident management have the right skills to revive the business following issues around mobile phone sales, scrapped EU roaming charges and a change to its Honeybee sales software.

At 199.35p, the shares are trading on a mere 8 times current year forecast earnings – implying that the bad news is fully priced in to its equity valuation. We have a 'buy' rating at the current price.

However, we must stress that Dixons' turnaround could incur some bumps along the way and therefore investors should not expect the share price recovery to go up in a straight line. (JC)

# Arena Events has the hallmarks of a great small cap investment

Take a look at this business which has high levels of recurring revenue and doesn't trade on an expensive valuation

We've spotted a very interesting company which has quietly got on with the job since joining the stock market last summer.

**Arena Events (ARE:AIM)** boasts high levels of recurring revenue (70%), it trades on an reasonable valuation and has clear potential to lift margins. It also has zero or negative working capital as many projects pay a significant sum upfront.

We believe Arena could be a good investment for anyone who is happy to buy into a company delivering a slow but steady increase in revenue and profit, supported by a circa 3% dividend yield.

## WHAT DOES ARENA DO?

The £69m business provides equipment to run major sports events and shows. Its structures and seating are used in such prestigious events as Wimbledon (tennis), the US PGA (golf), Cheltenham (horse racing) and the Chelsea Flower Show.

The UK accounted for 43% of revenue by geography in 2016; the US accounted for 40% and the remaining 17% came from the Middle East and Asia.

EBITDA (earnings before interest, tax, depreciation and amortisation) margins are higher

in the UK due to Arena providing additional services such as furniture and crockery hire. It wants to offer this broader suite of services in the US as that territory is currently dominated by the provision of structures (94% of revenue versus 56% in the UK).

To achieve this goal, chief executive Greg Lawless wants to make acquisitions to increase the company's presence in the US where it currently has a mere 1% market share.

First, a deal or two could help provide the capacity to offer non-structure services in the US and hopefully push up profit margins. Second, Lawless wants Arena to have a presence on the US west coast which is considered to be the largest rental market in the world. That could also help it to service national customers across North America on a more economic basis.

We're told there is a 'significant pipeline' of potential acquisitions. The more immediate prospects are bolt-on deals. Chief financial officer Piers Wilson says a larger deal would most likely require the company to ask shareholders for more cash. 'Our major shareholders at the time of the IPO indicated that they are keen to support us with additional equity when required,' he adds.

Arena recently bought specialist furniture hire business GDL Productions which provides furniture to concerts, music festivals, fashion shows, sporting and corporate hospitality events across the UK.

### OVERSEAS OPPORTUNITIES

The Middle East and Asia could see continued growth in the number of large international sporting events, as well as live music and cultural events, according to Arena.

For example, last year it won a two-year contract for the provision of structures and services for the inaugural CJ golf trophy in South Korea. This is a new tournament on the US PGA Tour.

Its Middle Eastern operations should benefit from early stages of construction work for the 2020 World Expo to be held in Dubai. Stockbroker Cenkos believes this event will have a 'particularly strong benefit' to Arena's 2019 earnings.

Although such large activities can provide a nice boost to earnings, Arena has tried to reduce its reliance on one-off events. It has also tried to smooth out its earnings across the year, as illustrated by the recent growth in the provision of temporary ice rinks.

**ARENA EVENTS**

| | 2017E | 2018E | 2019E |
|---|---|---|---|
| REVENUE (£m) | 100 | 107 | 113.9 |
| PRE-TAX PROFIT (£m) | 4.5 | 5.9 | 7.2 |
| EARNINGS PER SHARE (p) | 3.3 | 4.3 | 5.4 |
| DIVIDEND PER SHARE (p) | 1.4 | 1.8 | 2.2 |
| PE* | 17.9 | 13.7 | 10.9 |
| YIELD (%)* | 2.4 | 3.1 | 3.7 |

Source: Cenkos. Shares. *Based on 59p share price

'We're now busy nearly all-year round. Ice rinks and exhibitions have helped to reduce seasonality in the business,' says Lawless.

### LOSS-MAKING PAST

Pre-IPO Arena generated operating profit in the region of £1.15m for both 2015 and 2016, yet this was pale in comparison to the £2.7m (2015) to £3.6m (2016) of finance costs, meaning the business was loss making. That situation has now changed.

'We were owned by private equity before floating; they are now completely out. We had high yield loan notes which have now been repaid along with some bank debt,' says Wilson.

Arena recently guided for an £11.5m net debt position at the end of 2017. 'Net debt is now less than 1 times EBITDA,' adds Wilson. 'Our plan is to never go beyond 2 times EBITDA.'

In the UK, Cenkos says individual project margins are typically 30% to 40% (on a gross basis) for structures; and 25% over a full year. For seating work, individual project margins are typically more than 40%; and c35% over a full year. Interiors command 40% to 45% margins; and it's around 30% for ice rinks. Cenkos notes that ice rinks come with very few overheads and so command high EBITDA margins.

Nearly a third (30%) of EBITDA is reinvested into maintenance capital expenditure each year, says Wilson. All of Arena's products are reusable and transportation is outsourced to third parties.

Cenkos forecasts the company will announce £4.5m pre-tax profit for 2017 when results are published in April 2018. It reckons that figure will rise to £5.9m in 2018 and £7.2m in 2019.

**SHARES SAYS:** ↗

**At 59p, the shares trade on 13.7 times forecast earnings for 2018. That looks about right for this type of business.**

**If you assume it will continue to trade on the same rating, the shares could move up to c75p over the next 12 months based on Cenkos' 5.4p earnings per share forecast for 2019. That implies c25% share price upside over the next year, which would be a decent return.**

**Just remember; that's only an illustration of what may happen and nothing's guaranteed in the world of equity investing. (DC)**

**BROKER SAYS:** 1 0 0

# Investing for kids isn't just for the wealthy

How to get your children off to a head-start with Junior ISAs

There is a common misconception that investing for children is the preserve of wealthy parents.

It's actually possible to build a decent-sized nest egg by saving small amounts of money each month into a stocks and shares Junior ISA.

If you invest £30 a month from birth, your child could benefit from a pot worth £10,169 by the time they reach age 18, assuming an investment return of 5% a year after charges.

Investing £50 a month could produce a pot worth £17,723, while investing £100 a month could grow to £33,896, according to figures from AJ Bell.

This money could be hugely beneficial for a child going off to university or buying their first home.

## WHAT'S THE BEST INVESTMENT VEHICLE TO USE?

A stocks and shares Junior ISA enables you to invest money for your child in a tax-efficient way.

You can invest up to £4,128 this tax year and up to £4,260 in the 2018-19 tax year. There is no tax charged on the income or capital gains earned.

The money can't be accessed until your child turns 18, at which point it converts to an adult ISA. Your child is then free to withdraw some or all of the money or continue to invest.

'For this reason some people feel Junior ISAs are a great way to encourage long-term savings habits for their children who can, hopefully, see how saving and investing can make money work harder than holding cash or spending it,' says investment consultant Roland Kitson.

## HOW DO I OPEN A JUNIOR ISA?

You can open a stocks and shares Junior ISA with an online investment platform.

Many platforms have a regular investment service, which lets you set up monthly payments starting from just £25 a month.

The fees associated with regular investing are typically lower than with ad-hoc investing.

For example, AJ Bell Youinvest's Junior ISA charges £1.50 for buying and selling shares via regular investing, compared with £9.95 for ad-hoc dealing. Buying and selling funds costs £1.50 in either instance, and there is a 0.25% annual custody charge.

## IS THERE ANY POINT INVESTING SMALL AMOUNTS?

Investing little and often can turn into a decent-sized pot surprisingly quickly, particularly if you reinvest dividends.

In fact, evidence suggests regular monthly investing performs better than making large one-off or ad-hoc investments. This is because you smooth out the ups and downs of the stock market.

You buy more shares or fund units when prices are low and fewer when prices are high.

Simon Edelsten, manager of the **Artemis Global Select Fund (GB00B5QKCK29)** and **Mid Wynd International Investment Trust (MWY)**, says regular investing avoids parents having to worry about what the markets are doing. It ensures units continue to be bought after market falls, when the opportunity is often greatest.

'It can also be a good way of demonstrating to children the discipline and benefits of regular saving,' Edelsten adds.

### WHICH INVESTMENTS SHOULD I CONSIDER?

When you're investing for children you typically have a long investment time horizon, which means you can afford to take on risk.

History shows equities have the potential to deliver the strongest returns over a long period. However, to ensure a less bumpy ride it's important to have some diversification in your portfolio.

Funds such as unit trusts or investment trusts can be good ways to achieve diversification.

### WHERE DO I START?

Building a passive core in your child's portfolio can be a good starting point. You get broad market exposure and can add more opportunistic holdings alongside it.

Ryan Hughes, head of active portfolios at AJ Bell, suggests opting for **Fidelity Index World (GB00BLT1YP39)**, which tracks the MSCI World Index, giving exposure to the biggest and best-known companies in the world.

If you're comfortable taking on a little bit more risk, Hughes reckons **Liontrust Special Situations (GB00B57H4F11)** is a solid option. The actively-managed fund looks to identify companies that have a sustainable competitive advantage. It's typically biased towards medium and smaller companies.

**"If you're comfortable taking on a little bit more risk, Liontrust Special Situations is favoured by some experts**

**If you want a higher level of risk, investing in emerging markets such as China and India could be one route"**

If you want a higher level of risk, investing in emerging markets such as China and India could be a good option, for example through **Fidelity Emerging Markets (GB00B9SMK778)**.

'These markets offer the potential of faster growth over the long term but often come with higher risk. That said, when investing over a long period and on a monthly basis, some of this risk can be reduced,' explains Hughes.

Roland Kitson reckons parents should consider investments that take a long-term view. He likes **Impax Environmental Markets (IEM)**, an investment trust that invests in companies providing solutions to current and future environmental challenges.

'Because of its focus on mitigating and adapting to the effects of climate change, IEM can appeal to those who want to offer children the best personal future in more than just the financial sense,' Kitson says.

Another investment trust worth taking a look at is **Scottish Mortgage (SMT)**. Favoured by the experts at Seven Investment Management and European Wealth, it invests in a global portfolio of businesses with above-average historical returns. (EP)

# Time is running out for this one-off Lifetime ISA transfer trick

We run through all the important points so you can better understand the savings wrapper

## GET YOUR TRANSFER SORTED AHEAD OF TIME

If you want to take advantage of the Lifetime ISA bonus on offer for Help to Buy ISA transfers, you should start the process now.


Transfers tend to be completed in two to three weeks, but it's worth having some breathing room just in case something goes awry.

The last thing you want to do is miss out on the extra bonus cash simply because you left it until the last minute to sort out the transfer.


The clock is ticking for savers to swap their Help to Buy ISA for a Lifetime ISA and pocket an extra £1,100 in Government bonuses for the 2017/18 tax year.

The Help to Buy ISA has proven popular since it first launched in 2015. The latest official statistics show 143,894 bonuses had been paid to the end of September 2017, supporting over 100,000 first-time property purchases. The total value of these bonuses amounted to £104m.

However, for many the Lifetime ISA will prove a more attractive savings vehicle. Any transfer completed before 6 April 2018 could boost the value of your Lifetime ISA pot without using up your annual £4,000 allowance.

### HOW DOES IT WORK?

For this tax year only you can transfer the value of your Help to Buy ISA as it stood on 5 April 2017, and it won't count towards your Lifetime ISA allowance.

If you'd saved the maximum £4,400 in your Help to Buy ISA by this point and transfer before 6 April 2018, you'll get an extra £1,100 of bonus money straight into your account by transferring to a Lifetime ISA.

If you also used your entire £4,000 Lifetime ISA allowance on top of the transferred funds, you'd have a total bonus for the year of £2,100.

### SHOULD I CONSIDER TRANSFERRING?

There are a number of good reasons to swap your Help to Buy ISA for a Lifetime ISA.

First of all, your 25% bonus will be credited into your Lifetime ISA account within weeks, whereas the 25% Help to Buy ISA bonus is only added on completion of your property purchase, and so cannot benefit from any investment growth.

The allowances for the Lifetime ISA are also more generous, with savers able to pay in up to £4,000 a year versus £200 a month in a Help to Buy ISA (alongside an initial deposit of up to £1,200).

The amount of bonus you can receive through the Help to Buy ISA is capped at £3,000. With a Lifetime ISA you need to be aged 18-39 to qualify, and can keep contributing and receiving bonuses up until your 50th birthday. That means someone could receive a maximum of £33,000 in Lifetime ISA bonuses over their lifetime.

Finally, the Lifetime ISA allows tax-free withdrawal at age 60, meaning it could act as a handy extra retirement savings pot if buying a first home is no longer your priority.

### IMPORTANT POINT REGARDING TRANSFERS

Transferring to a Lifetime ISA won't be the right option for some people. If you're going to buy a property in the next year or two, investing in cash is the only way to completely avoid stock market fluctuations.

Help to Buy ISA rates for cash deposits are generally better than the rates currently on offer in the cash Lifetime ISA market.

It's also worth noting that your Lifetime ISA needs to be open for at least 12 months before you can use the funds to buy a first home.

Finally, if you think you might need your Help to Buy ISA for anything other than a first property purchase or before your 60th birthday, it might be worth staying put.

The Lifetime ISA comes with a 25% Government-imposed early withdrawal charge, meaning you might get back less than you originally invested. The Help to Buy ISA, on the other hand, has no early withdrawal charge.

| | Help to Buy ISA | Lifetime ISA |
|---|---|---|
| Age limit | n/a | 18 - 39 (and can keep contributing until 50th birthday) |
| Allowance | £200 per month (plus initial payment of up to £1,200) | £4,000 per year |
| Bonus added | On completion of property purchase | Annually (2017/18 only); monthly thereafter |
| Maximum available bonus | £3,000 | £33,000 |
| Minimum bonus | £400 | n/a |
| Early withdrawal penalty | n/a | 25% of funds withdrawn |
| Bonus | 25% | 25% |

# SHARES
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Attend the event on 15 March 2018 and you will be entered into a prize draw to win a **Fortnum & Mason Wayfarer Hamper worth £150** which will be presented on the night (Terms and Conditions apply)


## INVESTMENT TRUSTS FOR YOUR ISA AND SIPP

If you are looking to get a better grasp on your tax efficient investing opportunities and want fresh investment ideas for your ISA or SIPP then this is the event for you.

An expert panel from Shares and AJ Bell will guide you through their views on investment trust selection and the latest rules and uses for ISAs and SIPPs.

We will also be joined by four investment trusts that will explain their investment propositions so you can decide if they should be part of your investment mix.

**Brunner Investment Trust**
With a track record of 45 years of dividend growth the Brunner Investment Trust invests in companies throughout the world, seeking opportunities for growth and reliable dividends.

**Janus Henderson EuroTrust**
Europe is seen by many market commentators as a region that offers some compelling investment opportunities that have been overlooked by many investors. The Henderson EuroTrust, now in its 26th year, aims to deliver a superior total return from a portfolio of high quality European (excluding the UK) investments.

**Edinburgh Worldwide Investment Trust**
A very strong performer in 2016 and again in 2017 with a total return of over 45% for the year. The Edinburgh Worldwide Investment Trust has a global portfolio of entrepreneurial companies that it believes offer long-term growth potential.

**Standard Life Private Equity Trust**
Private companies and private equity funds can be difficult for many investors to get exposure to. The Standard Life Private Equity Trust provides investors access to this asset class by investing in a selection of leading private equity funds with an underlying portfolio of around 350 private companies.

Follow this link **www.sharesmagazine.co.uk/events** for full details and to register for your complimentary ticket.

### Experts from Shares and AJ Bell

**Daniel Coatsworth**
Editor – Shares Magazine

Daniel will be hosting the evening and explaining how he approaches investment trust selection.

**Tom Selby**
AJ Bell – Senior Analyst

Tom will be looking at the latest rules, uses and developments of ISAs and SIPPs and will explain how to take best use of the tax efficient advantages they offer.

**Event details**

**Registrations 17:45**
**Presentations start at 18:15**
Complimentary drinks and buffet available after the presentations

**Registration contact**

**Dimple Patel**
dimple.patel@sharesmagazine.co.uk
020 7378 4406

# Do investment trusts benefit from having a board of directors?

We explain the powers of a board versus how a fund manager operates and why it matters to investors

For many investors, the person running an investment trust is a key part of the reason they choose it. They may be attracted to a fund manager's impressive track record, contrarian style or the years of experience they bring.

What many investors fail to appreciate is that there's someone sitting above the fund manager overseeing the investment trust. That's the board of directors. They play a very important role which we'll now discuss.

### WHAT DOES THE BOARD DO?

Unlike open-ended funds (unit trusts and Oeics), investment trusts are run according to company law. They have an independent team charged with overseeing the running of the vehicle.

The board comprises a chairman, an accountant and various directors of different skills, who will ensure the manager fulfils his or her mandate and acts in the best interests of shareholders.

James de Sausmarez, director of investment trusts at asset manager Janus Henderson, says: 'The board challenges and questions, they ask why a manager is doing what they're doing, and I think managers enjoy the interaction.'

Crucially, the board also has the power to sack the fund manager if they feel he or she is not performing.

### THE BOARD IN ACTION

In February this year Miton fund manager Gervais Williams was removed from running **Investment Company (INV)**, an investment trust. He and colleague Martin Turner had managed the tiny trust, which has just £17m of assets, since 2013. The board appointed stockbroker and investment manager Fiske, saying there was a 'strong commercial rationale' for the change.

Back in November 2016, the board of BlackRock Income Strategies appointed Aberdeen as its new management company following a spell of mediocre performance under the leadership of BlackRock.

The latter had been in charge for the trust for less than two years and was originally brought on to revitalise the product when it was called British Assets.

### WHEN WOULD A BOARD DEMAND CHANGE?

James Budden, marketing director at Baillie Gifford, comments: 'While the majority of mandates don't move, sustained periods of underperformance, issues at the managing company or the departure of key staff are just some of the scenarios which can bring change at an investment trust.'

The board also has less dramatic tools in its armoury, with the power to change the mandate of the fund exercised more frequently.

In March 2017 **Aberdeen Frontier Markets (AFMC)** saw its policy amended from a fund of funds approach to investing directly in equities.

In June 2016, shareholders of **Scottish Mortgage (SMT)** voted to increase the proportion of assets the trust could invest in unlisted equities from 15% to 25%.

Sausmarez at Janus Henderson says, for the most part, a manager and board will work well together. 'Common flashpoints might include the level of gearing (debt) a trust has or the market outlook. Share buybacks are the board's decision and investment holdings are the manager's,' he explains.

## IS THERE A DOWNSIDE TO HAVING A BOARD?

Having a board is not without its disadvantages. Any team of highly skilled individuals need paying for their time and that adds to investment trust costs. But Mike Kerley, manager of **Henderson Far East Income (HFEL)**, says the benefits they bring 'more than compensate for the cost'.

Boards have also been widely credited for keeping fees of trusts lower than their open-ended counterparts.

Trusts are more likely to have tiered fee structures which allow investors to benefit from the economies of scale as a trust's assets grow. According to the Association of Investment Companies, more than a third of the industry has reduced its management fees since 2013.

Budden at Baillie Gifford says: 'The board is the shareholders' voice and can take action to improve things, and that is not the case in the open-ended industry.'

Certainly, the regulator seems to want the open-ended industry to take some guidance from its closed-end counterparts. Last year the FCA proposed new rules requiring funds to appoint at least two independent directors to their board. It said: '[Investors] need strong governance to act on their behalf. This does not appear to be happening currently.'

## CLEAR SUPPORT FOR BOARDS

A survey by Winterflood Securities found 51% of investors believe trusts benefit 'considerably' from having an independent board – just 2% thought there was no benefit. Respondents said it was 'part of the added value' of trusts and 'an important contributor to outperformance'.

> **If you're a private investor it's enormously comforting to know there is a group of highly qualified, diversely skilled people overseeing the manager**

Sausmarez adds: 'If you're a private investor it's enormously comforting to know there is a group of highly qualified, diversely skilled people overseeing the manager. Mutual funds don't have the same level of challenge.'

Yet while the board has the power to dismiss the manager, the manager has no such reciprocal authority. Board members, who are up for election each year, are answerable to shareholders, who can vote to have them dismissed.

Kerley adds: 'I don't have power over the board – they make decisions over and above senior management the same as with any listed company – but they live and die by their ability to meet shareholder expectations.'

The Janus Henderson fund manager meets with the board of his trust on a quarterly basis and enjoys the checks and balances an independent body provides.

They ask Kerley anything from basic questions about his process to more detailed queries about how the portfolio is positioned or why he has chosen particular stocks.

He says: 'It's important to have a good relationship and for the board to understand what you're trying to do. There are times when you do well and times when you don't, and you need a relationship based on respect and trust so you can explain why.

'I've experienced boards in the past where the relationship breaks down and that's when it can get quite tense.' (HB)

DISCLOSURE: Daniel Coatsworth, who edited this article, has a personal investment in Scottish Mortgage.

# Is it realistic to expect up to 15% annual return from a debt-focused fund?

Chenavari Toro Income aims to generate significant returns through lending

Fancy a juicy return of between 12% and 15% per year? Investment trust **Chenavari Toro Income (TORO)** is hoping to entice investors with such returns, although it hasn't been able to achieve that goal yet.

In this article, we explore what the investment trust does and unravel its complex structure so you can understand how it aims to deliver such returns.

## WHAT DOES IT DO?

Toro generates returns by lending money indirectly and directly to companies and consumers mainly in Europe via residential and commercial mortgages, car finance, corporate loans and trade finance.

Toro uses securitisation to generate returns, which sounds scary but is simply when an illiquid asset is transformed into a financial instrument with monetary value.

The investment trust buys loans in the market from companies, often looking specifically for debt that trades below its true value. When there are typically over 100 loans, these will be securitised through a collateralised loan obligation (CLO) controlled by the trust.

The debt is re-packaged into tranches and rated by agencies from AAA down to B and issued as floating rate notes that pay investors quarterly from the income from the original loans such as interest payments.

The notes rated AAA are set to be paid back first and as the ratings descend to B, the debt is progressively more risky as the investors take more exposure to the chance that a loan is not paid back versus AAA-rated notes.

## HOW DOES IT MAKE MONEY?

Essentially Toro keeps the difference it makes from buying debt cheaply and selling it for a premium.

Special purpose vehicles will also be used by Toro to lend to individuals. For mortgage loans, the investment trust has lent money to buy-to-let property owners through a partner with a banking licence.

Toro generates returns by lending money indirectly and directly to companies and consumers mainly in Europe via residential and commercial mortgages, car finance, corporate loans and trade finance

According to Toro, this is less risky as it is careful about to whom it lends money and looks for people seeking out a specific amount of funding for a mortgage. It can take advantage of interest rates circa 5%.

## IS THE PAYOFF WORTHWHILE?

The strategy behind Toro's returns is complicated and it has so far been unable to hit its 12% to 15% targeted returns.

In 2015, the investment trust delivered a total return of 4.53%; it achieved 3.85% in 2016; and 8.44% last year.

The trust's stock market prospectus stated that the targeted total returns are expected over three to five years once the trust is fully invested, which has now happened.

The investment trust struggled with cash drag in 2016 due to slower than expected investment via a new strategy. Cash represented 14% of the portfolio in 2016, declining to 2.2% in 2017.

Initially, Toro was focused on public asset-backed finance but decided to pursue more private transactions, including direct lending, which typically earn higher yields.

Unfortunately, it is not as easy as you think to lend money directly as the investment trust needed to set up arrangements to enable secure lending.

This strategy should be completed by the end of the year as Toro targets a 20% allocation for public asset-backed finance, down from 26.9% at present.

Exposure to private lending is expected to reach 30%, up from 23.6% at present. Direct lending between Toro and the borrowers, also known as direct origination, will comprise 45%. The remaining 5% is accounted by Toro's cash or liquid instruments.

Toro is taking advantage of European banks deleveraging after they loaned too much money to companies and consumers prior to the financial crisis in 2008

## WHAT CAN SUPPORT TORO'S PERFORMANCE?

Toro benefits from macroeconomic factors and improving economies, supported by falling unemployment and decent economic growth in the eurozone.

An expanding economy generally makes lending money less risky, according to some observers who believe there will be lower default rates and fewer people going into arrears.

If a borrower cannot pay the money back, the proportion of money that can be recovered is usually higher compared to countries that have lagging economic growth or are in recession.

Toro is taking advantage of European banks deleveraging after they loaned too much money to companies and consumers prior to the financial crisis in 2008.

Banks are more cautious in lending money and have been selling 'performing' loans to provide more income from interest instead of 'non-performing' ones. The latter is where the borrower misses agreed instalments by over 90 days.

One of the biggest risks for Toro is if interest rates rise as this could lead to more people defaulting on their loans.

Stronger regulations could also be troublesome, but senior portfolio manager Benoit Pellegrini believes the appetite for asset-backed finance remains strong at the moment. (LMJ)

# SOME BOND PRICES ARE GETTING CHEAPER: TIME TO INVEST?

## THE ASSET CLASS IS BECOMING MORE TOPICAL AS YIELDS ON GOVERNMENT DEBT MOVES HIGHER

After years of steady gains and limited volatility for fixed income or bonds this asset class is hitting the front pages as rising yields on government debt were one of the key precursors to the recent market correction.

If yields are rising it means bond prices are falling and money has flowed out of bond funds, potentially creating some value opportunities.

Typically fixed income doesn't normally attract the same amount of attention as shares, but it is nonetheless a useful option and shouldn't be ignored. Investors looking for income will appreciate the regular coupons, especially in view of the relatively low risk to their capital, and this also makes them a valuable source of diversification for those who want a more balanced portfolio.

**WHAT IS A BOND?**

A bond is essentially an IOU issued by a company, government or other body as a way of raising capital. In return, the bondholders are normally entitled to receive a fixed amount of interest, the coupon, at regular intervals until the debt matures, whereupon the issuer will repay the face value of the securities.

> A BOND IS ESSENTIALLY AN IOU ISSUED BY A COMPANY, GOVERNMENT OR OTHER BODY AS A WAY OF RAISING CAPITAL

For example, the Tesco Personal Finance 5% November 2020 bonds were issued in May 2012 and run for 8.5 years. The minimum investment at launch was £2,000 and they pay an annual coupon of 5% of the face value in two equal instalments.

### DIFFERENT TYPES OF BONDS

**The safest type of bond is generally considered to be a government bond, which is known as a gilt in the case of the UK government, as there is less chance of the issuer being unable to make the repayments as they fall due.**

**Corporate bonds have a slightly higher level of risk, as in the unlikely event that the issuer defaults, the bond holders could lose some, or all, of their money. Despite this issue, bonds can be much safer than shares in the same company as the prices are less volatile and the holders would be paid ahead of the shareholders if the business went into liquidation.**

**Investing in these sorts of bonds was beyond the reach of most private investors until the LSE launched its Order Book for Retail bonds (ORB) in February 2010. It is now home to 93 retail corporate bonds issued by well-known companies with a typical minimum investment of either £100 or £1,000, as well as 71 different gilts that can be bought for as little as £1.**

**Retail bonds should not be confused with mini-bonds, which are unlisted products issued by firms direct to investors and that are not subject to the same scrutiny required by ORB. These cannot be traded so investors are locked in for the full term and could lose their money if the issuer runs into difficulties as some have done in the past.**

**It is also important not to mix them up with fixed-rate bonds, which are fixed-rate savings accounts that are protected by the Financial Services Compensation Scheme up to a maximum of £85,000 per person, per institution. There is no such safeguard with any of the other types of bonds.**

### PRICES AND YIELDS

Bonds can be bought and sold and like other traded securities. Their prices can move up and down according to the market. These price movements will affect the yield to maturity – normally just referred to as the yield – for new investors.

For example, the Tesco Personal Finance bonds mentioned earlier were issued at a face value of £100, but the attractive interest rate has generated a lot of investor demand that has pushed up the price of each bond to £104.975.

Those who buy at this level would still be entitled to the £5 yearly interest, yet if they hold the bonds until they mature they would only get back the face value of £100. The yield to maturity reflects both elements and is the total return assuming all the repayments are made, expressed as an annual rate. In the case of the Tesco bonds it is currently 3.108%.

Corporate and government bonds are issued in a range of different maturities from three-month Treasury bills up to 50-year gilts and beyond, although most retail bonds fall somewhere in between these extremes.

Bonds from the same issuer with different maturities will have different yields that reflect the market's expectations of future interest rates. If you plot the yields against the maturity dates the resultant yield curve would normally slope up towards the right showing that investors usually want a higher yield from the longer dated bonds.

> BONDS CAN BE BOUGHT AND SOLD AND LIKE OTHER TRADED SECURITIES THEIR PRICES CAN MOVE UP AND DOWN ACCORDING TO THE MARKET

### RISKS AND REWARDS

The main risk of investing in a bond is that the issuer runs into financial difficulties and is unable to make the repayments resulting in a loss of interest and capital. This is known as credit risk with many bonds being given their own credit rating to provide an indication of where they stand.

Bonds issued by governments and large, well-financed blue-chip companies with less risk of default are known as investment grade, whereas the higher risk alternatives are referred to as higher yield to reflect the bigger coupons they must pay. If an issuer's financial situation deteriorates it would have an adverse impact on the price of its bonds and vice versa.

### WHAT ABOUT INTEREST RATES?

Another key area is the interest rate risk. When market interest rates increase they make the fixed interest payable on the bonds relatively less attractive. Investors will then sell them until the price falls far enough for the yields – the coupon divided by the price – to rise sufficiently to become competitive again. Higher inflation would have a similar effect and it is also worth bearing in mind that a lack of liquidity could make them difficult to sell.

The bonds that are most sensitive to these factors are the ones with farthest to go until maturity. These long duration bonds with cash flows that run well into the future have the most to lose/gain from higher/lower interest rates and will react accordingly.

Bond prices have benefited from the historically low rates of interest and many of them are now trading above their face value, although most private investors buy them mainly for their income rather than the potential capital gain. Some of the prices have recently started to weaken in anticipation of further interest rate rises.

If you are looking for a medium-term source of income the litigation finance specialist Burford's 6.5% 2022 bonds currently have a yield to maturity of 4.3%, with a shorter term option being the insurer Beazley's 2019 5.375% bonds that are yielding 3.03%.

**RISING INTEREST RATES COULD MAKE BONDS LESS ATTRACTIVE**

**Russ Mould, AJ Bell investment director, says that investors tend to adopt a buy-and-hold strategy until the next bond comes along from an existing issuer. 'Most issues have risen on listing, so they offer a yield-to-maturity that is below the stated coupon. This means that investors who switch into the new issue with the higher coupon can compound the capital returns made on the previously-purchased bond, as well as provide additional income.'**

### HOW TO INVEST

The easiest way to invest in a retail corporate bond or a gilt is to use your stockbroker to place a deal on ORB. Most brokers allow you to register to receive details of new issues so that you can invest when they first become available. You can also buy bonds that are already trading, but you may need to phone in your order as they may not be available on your broker's website.

Bond interest is paid gross, but the income is taxable and must be declared on your annual tax return unless you invest via an ISA or SIPP whereupon the income and gains are all tax-free.

A more diversified way to benefit is to buy a bond fund, where the manager will invest in a range of different securities to help spread the risk. The fund manager will aim to take advantage of the price movements to deliver a return based on both the income and capital gains, although investing in a fund will also incur additional costs.

One example is **Fidelity Strategic Bond (GB00B5M4BD49)**, which like other strategic bond funds can invest in different parts of the market to take advantage of the best opportunities. It is defensively positioned with a distribution yield of 1.9% and has returned 20.8% over the last five years. (NS)

# Why investors should stay sweet on Tate & Lyle

Value investors should take a closer look at the unloved global sweeteners giant

A souring of sentiment towards **Tate & Lyle (TATE)** is an opportunity for value investors to take a taste of the international business.

Recent earnings downgrades reflect year-to-date dollar weakness and margin pressure amid investment in the business. This has weighed on the equity valuation.

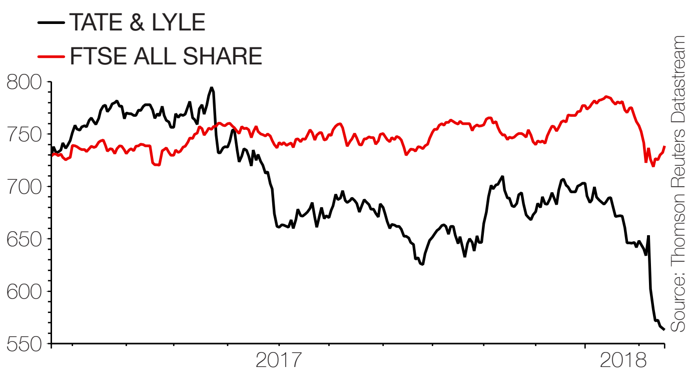
But Tate & Lyle is on the path of a sustained recovery and has a positive catalyst in the promotion of CFO Nick Hampton to CEO, providing the prospect of a renewed strategy to accelerate the £2.62bn cap's transformation to a speciality ingredients play.

## SPLENDID POTENTIAL

Tate's two divisions are the relatively commoditised Bulk Ingredients unit, selling bulk sweeteners and industrial starches, and Speciality Food Ingredients (SFI), the long-term growth driver, whose products span texturants such as starch and gums, sweeteners, comprising nutritive sweeteners and no-calorie sweeteners including 'SPLENDA Sucralose'.

Following a testing few years of transformation towards a higher margin, less volatile speciality ingredients supplier, Tate is in a far healthier position operationally.

However, its third quarter update (8 Feb) was harshly punished. Though it reiterated profit guidance for the year to March 2018, management cautioned that investments behind the longer term development of the SFI business 'will moderate profit growth in the second half'.




## TATE'S TOO CHEAP

As Investec Securities explains in its latest note (12 Feb), 'we appreciate there is a degree of investor fatigue with the multi-year SFI strategy not yet delivering the hoped-for benefits. But, Tate is now VERY cheap and new management may well offer better ideas for value creation.'

The broker reiterates its 'buy' rating on valuation grounds and a 735p price target implying 29.5% upside. Significantly, Investec's 903p sum-of-the-parts valuation is almost 60% higher than the current battered share price.

We think Tate & Lyle is oversold. For the year to March 2018, Investec still forecasts an increase in normalised pre-tax profit to £302.3m (2017: £271m) for earnings of 49.3p and a 28.6p (2017: 28p) dividend, ahead of pre-tax profit of £305m, 49.8p of EPS and a 28.8p shareholder reward for March 2019.

**SHARES SAYS:** ↗

**At 567.8p, Tate & Lyle looks great value on 11.5 times this year's earnings and a 5% dividend yield. Buy ahead of May's full year results, where Hampton, who'll be handed the CEO baton from Javed Ahmed on 1 April, could boost the share price when communicating his plans for the business. (JC)**

**BROKER SAYS:** 5 8 0

# Profitable franchise group Filta has a plan to crack Europe

The deep fat fryer specialist has bought back the German master franchise and hired a successful Dutch entrepreneur

Franchise group **Filta (FLTA:AIM)** has confirmed its strategy to crack Continental Europe.

The £47m business has established an office in Holland to initially service Germany. Once successful, the same office will be used to service other European countries likely to include Denmark, Portugal and Spain.

To kick-start the strategy, deep fat fryer specialist Filta has bought back the master franchise for Germany from Dutch owner and successful entrepreneur Jos van Aalst. 'We approach Jos,' says chief executive Jason Sayers. 'He's now going to run Filta's European business.'

Filta will replicate its US model which provides a centralised office, recruitment services and finds work for the franchisees.

Its franchisees clean fryers in restaurants, schools, casinos, hospitals, sports stadiums and offices among many other locations. They also provide oil recycling and drainage services.

Sayers reveals six existing German franchisees have each committed to adding more vans to their patch. He says the country has a lot of similarities to Filta's existing focus in the US, UK and Canada, as well as having some local drivers. 'For example, Germany has a lot of furniture stores with restaurants inside them, a bit like Ikea in the UK.'

European expansion will focus on cities and areas with lots of fried food such as the Algarve region of Portugal.

The company last month sold its refrigeration, heating, ventilation and air conditioning business for a deal worth up to £125,000. Sayers remarks that it was low margin and that Filta prefers to have high levels of repeat revenue and high margins.

In the US, Filta is taking on new franchisees and existing ones are expanding at an increasing rate, according to the CEO.

UK expansion is slower but Sayers is confident about the future thanks to last summer's acquisition of Grease Management drain services business, a strong performance from its FiltaSeal business and improved management of the UK operations.

There are also good signs from its first franchisee in Canada. 'They've now added their third van, all in the first three months of trading. It's aggressive but not unusual.'

The company's broker Cenkos forecasts 2017 results (set to be published on 17 April 2018) will show £2.3m pre-tax profit (2016: £2.1m), rising to £2.8m in 2018.

Revenue guidance from Filta of more than £13.25m in 2017 is better than Cenkos' £12.5m forecasts. However, the number of mobile filtration units (MFU) per franchisee at 392 units is less than the 409 expected by the broker.

Cenkos says the revenue beat implies higher revenue per MFU. 'This is consistent with the company's focus on supporting and growing with quality franchisees,' says Cenkos analyst Zane Bezuidenhout.

**SHARES SAYS:** ↗

**Filta remains one of our top picks in the small cap space. Buy at 172p. (DC)**

**BROKER SAYS:** 1 0 0

# Nanoco's share price nearly doubles in a week

Displays technology developer is back in favour but there are reasons to be wary

Shares in cadmium-free quantum dot technology developer **Nanoco (NANO)** are on the move as the company signs a commercial supply agreement with a large US electronics manufacturer.

The news excited investors to chase the stock from 23.55p to heights of 44.35p, before easing back to the current 39.4p. But *Shares* believes that investors need to tread carefully. This is not the first material supply deal it has signed and yet meaningful revenue remains stubbornly elusive.

Nanoco has had supply deals for its cadmium-free quantum dot technology in place since 2014 (with Dow Chemical), with a second major agreement with Merck coming in 2016. However, revenue in the year to 31 July 2017 barely topped £1.3m and was dwarfed by operating losses of £10.9m.

While the latest contract is welcome news, Nanoco has been seemingly on the cusp of a major financial breakthrough for years. Estimates for 2017 published by the company's broker Peel Hunt in November 2016 suggested £7.8m of 2017 sales, rising to £21.9m in 2018.

Those estimates proved wildly optimistic with 2018 revenues now anticipated at £7.5m, demonstrating how long it takes for commercialisation to find scale. (SF)

## Ebiquity sells market intelligence arm to focus on growth opportunities elsewhere

### Consultancy firm to pay £26m for AdIntel business

MARKETING ANALYTICS FIRM **Ebiquity (EBQ:AIM)** is looking more streamlined having agreed the £26m sale of its AdIntel division to global consultancy Nielsen (13 Feb).

This business formed the bulk of the group's Marketing Intelligence operation – which aids firms in understanding their market and what other companies are spending cash on. Chief executive Michael Kargs tells *Shares* this has increasingly become a 'commoditised' area.

The proceeds from the deal are expected to reduce Ebiquity's debt-to-earnings ratio from 2.1 to 1.0-times.

Recent management focus and resources have been centred on the company's higher margin and faster-growing Media Value Measurement (MVM) and Marketing Performance Optimisation (MPO) arms.

These apply technology to help companies understand the effectiveness of their marketing and advertising to help ensure promotions have a greater impact in the future.

Although these businesses have significant potential, a trading update accompanying news of the disposal confirmed previous guidance that both MVM and MPO have underperformed in the US.

Numis, which has a 'buy' rating and 145p price target on the stock, says the problems across the Atlantic are 'being addressed by new leadership, though margins were impacted in 2017'.

As such it has trimmed earnings per share forecasts for 2017 from 10.5p to 9.7p; and for 2018 from 9.4p to 8.3p.

Profitability already faced some pressure thanks to a programme of significant investment which is set to peak in 2018. (TS)

## KEY

- **Main Market**
- **AIM**
- **Fund**
- **Investment Trust**













THIS WEEK: 18 PAGES OF BONUS CONTENT

# SHARES SPOTLIGHT

N4 PHARMA

NETSCIENTIFIC

PLUTUS POWERGEN

POWERHOUSE ENERGY

SERVOCA

VALIRX

## *Growth & Innovation*

INCLUDES COMPANY PROFILES, COMMENT AND ANALYSIS

FEBRUARY 2018

# Introduction

## Welcome to *Spotlight*, a bonus magazine which is distributed eight times a year alongside your digital copy of *Shares.*

Spotlight provides small caps with a platform to tell their stories in their own words.

The company profiles are written by the businesses themselves rather than by *Shares* journalists.

They pay a fee to get their message across to both existing shareholders and prospective investors.

These profiles are paid-for promotions and are not independent comment. As such, they cannot be considered unbiased. Equally, you are getting the inside track from the people who should best know the company and its strategy.

Some of the firms profiled in *Spotlight* will appear at our investor evenings in London and other cities where you get to hear from management first hand.

Click here for details of upcoming events and how to register for free tickets.

Previous issues of *Spotlight* are available on our website.

# State of AIM report

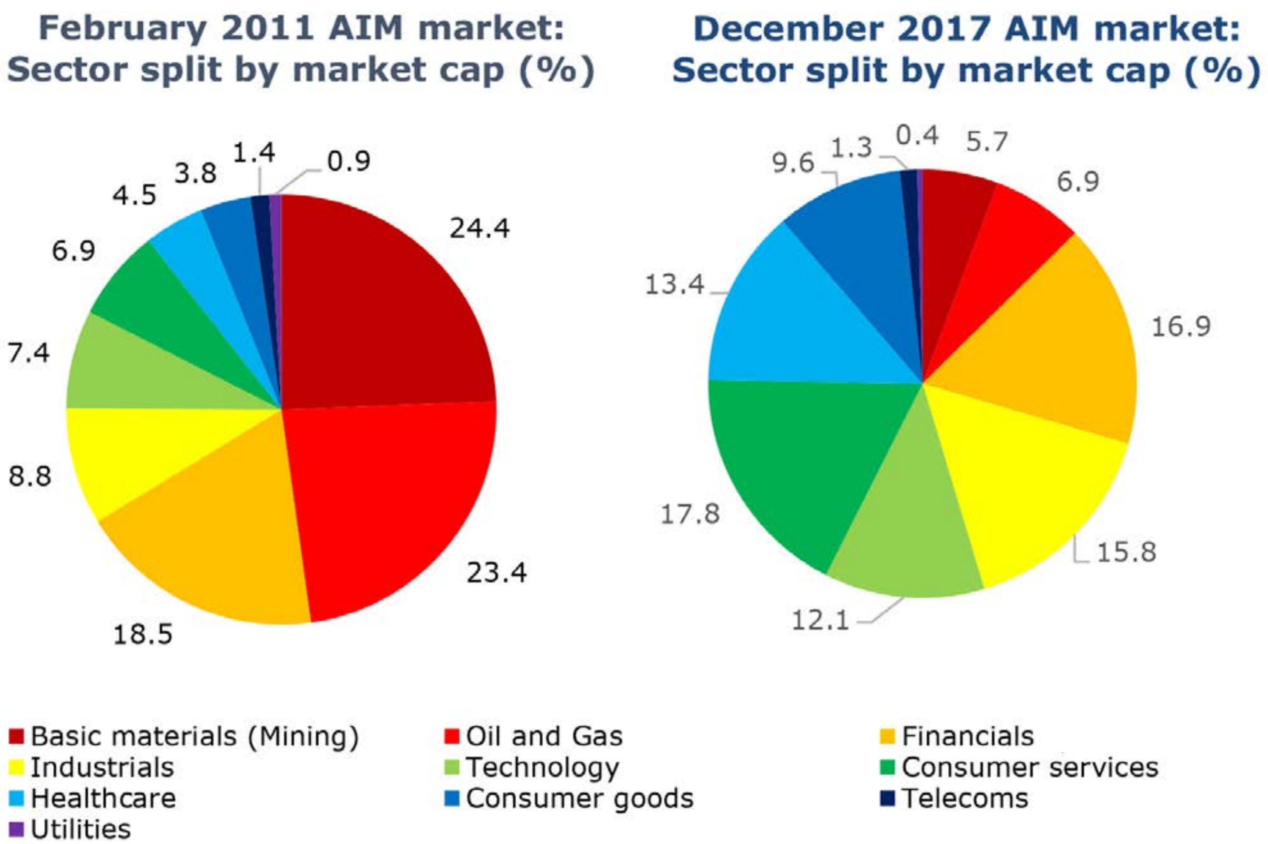
## Research shows the outperformance of London's market for growth companies and its changing composition

**In our November edition of Spotlight, we looked at the strong performance of AIM shares since they became eligible for inclusion in ISAs back in 2013. Now research house Equity Development has taken an in-depth look at the current state of London's junior market.**

In recent years we have written a series of notes on AIM, and its performance relative to the FTSE All-Share Index. We published the first of these notes on 5 August 2013, the very date that AIM listed shares were (finally) permitted to be included in ISA accounts.

At the time we suggested that this one change would be the catalyst to AIM starting to outperform the FTSE All-Share, after many years of relative underperformance. Our 'bullish call' has proved to be absolutely spot on.

Two subsequent events, both in the spring of 2014, in the form of the abolition of stamp duty on AIM share purchases, and George Osborne's 'death of annuities' budget, which made the inheritance tax planning advantages of holding AIM shares much more




*Source: LSE AIM market statistics*

relevant, further significantly strengthened AIM's 'hand'.

AIM has consistently outperformed since then and has enjoyed a buoyant 12 months: in 2017 the AIM All-Share Index rose 24%, while the more concentrated AIM 100 Index rose a very impressive 33%. In sharp contrast the FTSE All-Share Index rose a modest 9%, and the FTSE100 just 8%.

### AIM an important market for private investors

The Office for National Statistics released a paper on 29 November 2017 entitled 'Ownership of UK quoted shares' (which related to data at the end of 2016). It stated that 29.7% of all AIM shares are held by individuals, and a further 11.3% by Unit Trusts, where 'individuals' are presumably in most cases the ultimate owners.

These high numbers confirm the increasing all-round attractions of AIM to private investors, swollen by a combination of more AIM companies paying dividends and the £20,000 per annum ISA allowance encouraging greater individual ownership.

We are now in a new, post MiFID II world, with the number of brokers' analysts continuing to decline at a pretty alarming rate (with institutional equity commission effectively now a thing of the past). Going forward, the key for AIM companies wishing to continue to perform is to ensure that their broad investor base has free & widely available access to research & forecasts.

This should no longer be the sole preserve of the select group of institutions which are now being obliged to pay hard cash to brokers for their research.

### Changing composition of AIM

As recently as February 2011, Basic Materials (Mining shares make up approx. 70% of the Basic Materials sector) plus Oil & Gas dominated AIM at 47.8% of AIM's entire market cap.

At the time of our last update, using March 2017 stats, Basic Materials (inc. Mining) and Oil & Gas represented just 15.7% of AIM, and by the end of 2017 this combined number had dropped to an all-time low 12.6%, and this despite the oil price currently being at a three-year high!

In sharp contrast, the Consumer Goods & Consumer Services sectors have risen from a combined 10.7% in February 2011 to 27.4% now. Other sectors moving strongly in the 'right' direction in recent years include Healthcare and Technology.

This text is taken from Equity Development's *AIM's spectacular 3 year run* research report published on 16 January 2018

### 2017: ANOTHER EXCELLENT YEAR FOR AIM

There is absolutely no doubt that AIM ended last year in fine fettle. As at 31 December 2017, AIM could claim:

- Record average AIM company market capitalisation of £109.4m
- Record 14 companies over £1bn market cap plus a further 217 over £100m
- Record proportion of AIM constituents paying a dividend
- 184 AIM companies have made the move onto the LSE full list
- Much more evenly balanced sector split, with Mining and Oil & Gas no longer dominating AIM (and arguably hindering its performance) as they did for most of its early years
- £105.4bn of new money has now been raised (for companies) in AIM's 22 year history: new money raised at IPO £43.2bn, follow on (secondary) company raises £62.2bn
- Decent performance by the vast majority of 2017's AIM IPOs, with a healthy pipeline going into 2018

# N4 Pharma is focused on delivery

**Website:** www.n4pharma.com

Founded in 2014, **N4 Pharma (N4P:AIM)** is a specialist pharmaceutical company with two separate divisions. The first division is focused on reformulation of generic drugs, the second division is a novel delivery system for cancer vaccines and therapeutics.

Developing a new drug is very expensive and risky, it can often take over ten years and cost upwards of £1bn with less than 5% chance of the drug successfully coming to market. Reformulation is quicker, cheaper and far less risky taking approximately two to three years and less than £5m to bring each reformulated drug to market.

## REFORMULATED RETURNS

N4's business model is to get their reformulated products to a point where they can be commercially licensed to larger pharmaceutical companies, in return for up front milestone payments and ongoing future royalties from product sales. The regulatory pathway for such products is already well established. N4 is reformulating a range of products backed by patent applications, each of which is targeting annual sales of over £300m thereby providing a portfolio of reformulation opportunities.

Each one of these opportunities has the potential for high returns from relatively low levels of expenditure when compared to traditional drug or biotech product development. Their lead product in this division is the reformulation of sildenafil, more commonly known as Viagra.

Viagra was originally developed as a cardiac drug, but it was repositioned to treat erectile dysfunction. As a consequence, it does not have the perfect product profile for the treatment of ED.

It takes approximately one hour to take effect, lasts for roughly six hours and should not be taken with food. Other companies developed their own products looking to improve on one of these three disadvantages, but no drug has been developed to tackle all three problems at once.

N4's reformulation is designed to do just that by improving the onset of the drug in the body, making it last longer and allowing it to still work when taken with food. N4's product is entering initial proof of concept clinical trials in Q1 2018 with results expected in Q2 2018.

The company will then look to present the findings along with a plan for a further pivotal trial to the FDA to seek guidance on its route to marketing authorisation. At this point N4 will either look to license its product to a partner to perform the final trial or seek to raise funds to do the trial itself resulting in higher royalties once marketing approval is granted.

**WHO IS N4 PHARMA?**

**A SPECIALIST COMPANY WHICH BOTH REFORMULATES GENERIC DRUGS AND PROVIDES A NOVEL DELIVERY SYSTEM FOR CANCER THERAPEUTICS AND VACCINES.**

## A CONSISTENT MODEL

Vaccine development is a much longer and more expensive process compared to generic reformulation, however N4 has adopted a very similar business model in this space to its reformulation division.

It has licensed a novel silica nanoparticle from the University of Queensland in

Australia for the exclusive development of vaccines and therapeutics using nucleic acids, initially focusing on DNA and RNA.

Just as with the generic division, the silica nanoparticle system (named nuvec) provides multiple opportunities to license it to large pharmaceutical and biotech companies developing cancer vaccines and therapeutics using their own nucleic acid compounds.

N4's strategy is to develop its nuvec system to the point where it can be licensed to other pharmaceutical companies to take their own products into clinical trials, spending a similar amount required for reformulating a generic drug. N4 is not intending to spend exorbitant sums of money developing a novel vaccine, this responsibility falls on the partner. N4 will provide the delivery platform to help its partners develop more effective vaccines.

In order to achieve this N4 has in place a research program for nuvec to provide proof of concept information that it can use to enter commercial collaboration agreements with companies and ensure that nuvec is ready to enter human clinical trials by the end of 2020. This model allows N4 to receive early up front and milestone payments when nuvec is licensed and is not solely reliant on future royalties as many partner products could possibly fail in development.

## MULTIPLE OPPORTUNITIES

N4 is operating a multi opportunity model with high rewards for low initial expenditure. The Global nanotech drug delivery market is forecast to reach $11.9bn by 2023; dominated by cancer applications*, providing a vast number of licensing opportunities for nuvec. In early February 2018, N4 announced a collaboration with MedImmune UK, a key player in DNA vaccine delivery and is looking to develop further collaborations in 2018 as its research program evolves.

Nuvec has a unique spiky design developed to allow DNA or RNA to attach to these spikes in sufficient amounts to deliver the required treatment dose. These spikes help protect the nucleic acid from degradation due to exposure to nuclease and experiments have already shown the ability for nuvec to achieve excellent cellular transfection and evidence of a good potential immune response.

Most companies developing new vaccines using nucleic acids use some form of lipid nanoparticle system, but these systems have disadvantages in terms of dose, protection and toxicity. Nuvec is designed to improve vaccine delivery and is being positioned as the best alternative to lipid nanoparticles for nucleic acid vaccine delivery.

N4 completed a successful placing to raise £1.7m which will enable them to produce initial human clinical data to establish the pharmacokinetic profile of their sildenafil reformulation and help to determine how they will position the Nuvec vaccine delivery system for the best approach to engage with vaccine companies. The Company believes that they will have enough funds to see them through 2018.

## IN A NUTSHELL

In summary N4 Pharma is a multi-opportunity pharmaceutical company operating a potentially low risk, high reward business model for successful product development across both generic reformulation and vaccine delivery.

* Source: Technology market research 2017

# NetScientific pursues a game-changing approach

## Website: www.netscientific.net

NetScientific (NSCI:AIM) is a transatlantic healthcare IP commercialisation group focused on sourcing, funding and commercialising technologies and companies that have the potential to treat chronic disease and significantly improve the health and well-being of patients.

**STRATEGY:**
Netscientific's business strategy is based on funding and building game-changing healthcare technology companies towards value inflection points and eventual exit including through a trade sale or public listing.

The group sources opportunities from global institutions, leading technology incubators and its deep healthcare network. In the early stages of the company's development the group provides extensive management support including technical guidance, administrative support, legal, IP and commercial expertise. As companies mature through key milestones the group will recruit experienced industry leading CEOs to drive the next phase of growth, attract additional external capital and secure favourable exits.

**MANAGEMENT:**
NetScientific is differentiated by its executive management team and board, who bring substantial operational and industry experience.

Sir Richard Sykes, non-executive chairman of the group, joined NetScientific in 2008. Sir Richard spent thirty years working in the biotechnology and pharmaceutical industries, including at Glaxo plc (subsequently Glaxo Wellcome plc), where he served as chairman and CEO from 1995 to 2000, and then **GlaxoSmithKline (GSK)**, where he served as chairman until 2002.

Francois Martelet, CEO, brings over 20 years of biopharma experience and a proven track record of shaping and developing businesses to deliver returns. He was previously CEO at Topotarget A/S, a publicly traded European biotech company specialized in oncology therapeutics and CEO of Avax Technologies Inc., a US biotech company specialized in therapeutic oncology vaccines.

Ian Postlethwaite, CFO, brings over 14 years of biopharma experience and a proven track record of driving revenue growth and funding development programs. He has broad experience in both private and public companies; from start-ups to multi-nationals. He was previously an executive director on the board of **Allergy Therapeutics (AGY:AIM)**.

**PORTFOLIO:**
Our portfolio is split across three primary areas of focus: Digital Health, Diagnostics and Therapeutics.

- **Digital Health**

**WHO IS NETSCIENTIFIC?**

**NETSCIENTIFIC IS A TRANSATLANTIC HEALTHCARE IP COMMERCIALISATION GROUP FOCUSED ON SOURCING, FUNDING AND COMMERCIALISING TECHNOLOGIES AND COMPANIES THAT HAVE THE POTENTIAL TO TREAT CHRONIC DISEASE AND SIGNIFICANTLY IMPROVE THE HEALTH AND WELL-BEING OF PATIENTS.**

Using data to provide clinical grade actionable insight.

- **Diagnostics**

Novel highly specific tests to provide earlier diagnosis, accurate monitoring of disease progression and the ability to personalize therapy based on an understanding of individual ability to respond to treatment.

- **Therapeutics**

Novel mechanisms of actions, new targeted delivery methods and safe but highly personalized therapeutic options to significantly improve or cure the disease.

All of the companies NetScientific invests in are next generation healthcare technologies offering solutions that can make a real difference to healthcare payors facing increasing pressure from social burden.

A brief overview our main portfolio companies is provided below:

## DIAGNOSTICS (GLYCOTEST, PROAXSIS AND VORTEX):

**Glycotest**

Glycotest is a US based liver diagnostics company seeking to commercialise new and unique blood tests for life threatening liver cancers and fibrosis-cirrhosis with exclusive world-wide rights to over 50 patent-protected serum protein biomarkers.

Glycotest's lead product is its HCC panel, a biomarker panel driven by a proprietary algorithm for curable early-stage hepatocellular carcinoma (HCC), the most common form of primary liver cancer. The market for HCC testing is large and growing with currently three million patients and in excess of US$800m in the US alone.

**ProAxsis**

ProAxsis is a medical diagnostics company based in Northern Ireland, developing a range of products for the capture, detection and measurement of active protease biomarkers of diseases.

The rapid and easy-to-use tests ProAxsis has developed incorporate patented ProteaseTags; smart molecules which trap an active protease within a complex biological sample and enable a visual readout of its presence.

The initial applications for the technology are focused on managing the chronic respiratory diseases, Cystic Fibrosis (CF) and Chronic Obstructive Pulmonary Disease (COPD), where exacerbations have a major impact on the long-term prognosis of patients. There are 70,000 patients diagnosed with CF worldwide and 35.7m patients with COPD in the US and EU alone.

**Vortex Biosciences**

Vortex Biosciences is a US based cancer diagnostic company, developing a novel liquid biopsy automated instrument (VTX-1) and microfluidic cartridge for the isolation of circulating tumour cells from whole blood without the need for any pre-treatment.

The label-free technology enables high purity and collection efficiency of intact circulating tumour cells in less than an hour. The technology enables researchers and clinicians to non-invasively capture, identify, analyse and enumerate tumour cells for use in downstream clinical applications such as cancer diagnosis and monitoring, personalised medicine, drug development, and cancer research in the estimated $22bn liquid biopsy market (JP Morgan Liquid Biopsy Report – 27 May, 2015).

## DIGITAL HEALTH (WANDA):

Wanda is a San Francisco based digital health company commercialising advanced clinical decision support software. Wanda aims to significantly reduce hospitalisation risk, and improve the quality of life for people with chronic conditions, initially focused on congestive heart failure (CHF).

In the US chronic disease accounts for 80% of the total health care bill and represents a $1.4tn expenditure, a significant proportion of which is avoidable through better management and appropriate clinical interventions.

## THERAPEUTICS (PDS BIOTECHNOLOGY):

PDS is a clinical stage immunotherapy company developing a next-generation of simpler, safer and more effective immunotherapies for cancer and infectious diseases. Versamune–its novel synthetic nanoparticle platform technology–activates multiple immunological mechanisms which direct the targeting of cancer and infectious disease by the immune system.

PlutusPowerGen

# Plutus PowerGen is tackling UK energy deficit

**Website:** www.plutuspowergen.com

The energy environment in the UK is tightening rapidly and **Plutus Powergen (PPG:AIM)** is focused on mitigating the current and forecast risk of an energy deficit by developing a portfolio of 20MW (megawatt) power sites, which can be switched on at a moment's notice at times of peak demand.

## THE NEED FOR FLEXIBLE ENERGY

Flexible energy is becoming increasingly necessary and prominent in the UK as its energy mix changes to include renewables, which by their very nature provide power intermittently. Combined with this intermittency, nuclear and larger carbon intensive sources of generation are being retired, meaning that the supply-demand margin is becoming increasingly constrained.

Plutus' team of industry and financial experts recognised the imbalance in energy supply and, from a standing start in 2015, have rapidly grown the company; it already has six 20MW projects in operation, 160MW under development, 200MW in planning for 2018 and is targeting the construction of a further 200MW in 2019. The first nine 20MW projects are being funded via EIS/Rockpool Investments straight through to newly created SPV (single purpose vehicle) with Plutus retaining a 45% interest as well as earning management fees.

These sites take circa 12 months to develop and hold capacity mechanism (CM) contracts for 15 years. It is envisaged that going forward the company will look to retain 70% - 80% of future projects utilising strong relationships with key partners.

To this end, the company continues to build its strong partnership network: it has an agreement with a UK 'Big Six' energy company, which will fund 20% of any 20MW FlexGen and storage project going forward; and an MOU with JCB for the provision of 60% asset funding of its new majority owned portfolio.

The company is in advanced dialogue with a variety of potential partners to bridge

## WHO IS PLUTUS POWERGEN?

**AIM LISTED PLUTUS POWERGEN IS AN ENERGY COMPANY FOCUSED ON THE DEVELOPMENT, CONSTRUCTION AND OPERATION OF FLEXIBLE ENERGY GENERATION (FLEXGEN) PROJECTS IN THE UK.**

the 20% balance of funding required. A decision is likely to be made in the near future.

The company also has an agreement with land and property developer, London & Devonshire Trust Ltd (LDT), to identify and develop energy storage projects in the UK. This is in line with its strategy to widen its exposure within the UK energy sector and diversify its offering through the development of hybrid sites that, in addition to generation, incorporate energy storage technologies.

## WHAT IS THE FINANCIAL POSITION OF THE COMPANY?

Plutus' current revenue model is based on multiple streams including Short Term Operating Reserve (STOR) and Firm Frequency Response (FFR) – on both of which the counterparty is **National Grid (NG.)**. Additionally, the company is in receipt of the prevailing power price at the time of generation when energy market prices warrant. This is in the form of a Power Purchase Agreement (PPA) with an energy company.

The project financials of a typical site within its 70% - 80% owned 25 site portfolio are compelling. Each site, running for about 2,000 hours per annum, cost circa £12.5m to build and will generate EBITDA (earnings before interest, tax, depreciation and amortisation) in excess of £3m per year when CM payments commence, giving a potential IRR (internal rate of return) of over 20%.

It is important to emphasise management's determination that Plutus funds its business through non- dilutive means. Consequently, and in tandem with the management contracts it receives from the likes of Rockpool that currently provide circa £1.35m annually, the Company has not needed any equity raises since shortly after admission to AIM three and a half years ago and does not contemplate any going forward.

## A STRONG TEAM

The team has a proven track record of value creation and extensive sector experience. CEO, Phil Stephens, and COO, Paul Lazarevic, both previously held senior roles in the energy industry. Phil worked with a power generator and has held board positions on several international energy utilities, whilst Paul was previously CEO of a grid balancing technology company and also held positions at RWEnpower and ExxonMobil. On the corporate side, chairman Charles Tatnall, has a background in funding and building SMEs and has held several directorships with both private and listed companies in the US, Canada and the UK and CFO, James Longley is a chartered accountant with considerable experience in growing private and public companies.

## WHAT IS THE OUTLOOK?

Plutus continues to make rapid progress on many fronts as it focuses on delivering near and longer term returns for shareholders.

It has a good track record having brought six projects to fruition in a short time-frame and developed a meaningful pipeline of new sites, some of which are currently being commissioned and others are at an advanced stage of receiving planning permissions.

Plutus is an evolving story. Its diversification into different power generation and energy storage types highlight its adaptability. Furthermore, its strong relationships with LDT, one of the big six utilities and JCB, which between them bring land, finance and funded generation equipment, should enable Plutus to execute its aggressive growth strategy and deliver on its strong pipeline.

# PowerHouse Energy to turn waste into hydrogen

**Website:** www.powerhouseenergy.net

Keith Allaun, CEO of PowerHouse Energy

**PowerHouse Energy's (PHE:AIM)** vision is to propel the UK's burgeoning hydrogen economy whilst ridding the country of the scourge of waste plastic. Within 10 years, PowerHouse intends to develop a network of up to 200 waste-to-hydrogen plants around the UK. The plants are compact, so they can be built close to the source of waste, and do not produce harmful by-products or require a smokestack. Each unit is designed to consume about 25 tonnes a day of waste plastic or used tyres.

The UK currently exports 500,000 tonnes of waste plastic each year for recycling overseas but much of this plastic isn't recycled. Instead it finds its way via streams and rivers into our oceans. The Chinese government recently announced it would no longer accept waste plastic from the UK; instead this plastic is being exported to other countries such as Turkey, Malaysia and Vietnam.


Small footprint: computer graphic of a distributed hydrogen station

## DEALING WITH THE WASTE PROBLEM

Keith Allaun, the CEO of PowerHouse Energy, says: "It's an absolute scandal that the UK exports waste plastic. Much of it won't be recycled, there's a carbon footprint to shipping it and the plastic recycling industry in the third world is one of human misery.

'Around 300m tonnes of new plastic is manufactured each year so waste plastic is a problem that's not going to go away: we need sustainable technologies to recycle, transform or destroy it.'

PowerHouse Energy has developed just such a technology. Called Distributed Modular Gasification, DMG, a proprietary technology designed to transform waste plastic as well as used car tyres, into hydrogen and electricity in an environmentally benign way. In fact, the DMG system can be used to generate electricity from almost any waste stream.

## WHO IS POWERHOUSE ENERGY?

**AN AIM-QUOTED COMPANY WHICH HAS DEVELOPED A PROPRIETARY TECHNOLOGY TO CREATE ENERGY FROM WASTE.**

Keith Allaun says: 'The hydrogen economy has been held back by the cost of producing and transporting hydrogen and also by the fact that current hydrogen production produces significant quantities of the greenhouse gas carbon dioxide. Our system produces hydrogen much more cheaply, at about the same cost as diesel, and produces one sixteenth of the CO2 produced by standard processes.'

The DMG system is based on gasification, a method in which ultra-high temperatures are used to decarbonise waste such as plastic and turn it into synthesis gas, or 'syngas'. PowerHouse's technology modulates this syngas to produce hydrogen of a very high purity, which has been independently confirmed as road fuel quality.

Demonstration unit: the DMG process in action at Thornton Science Park

## TARGET MARKETS

'Hydrogen-powered fuel cell vehicles are our first target market. There are already fleets of hydrogen buses in London and other UK cities, there are diesel lorries being converted with hydrogen as a dual fuel and, in California, the use of hydrogen cars is growing rapidly. Hydrogen vehicles are environmentally the most friendly form of transport, as all they produce as exhaust is water vapour. To power this form of transport by destroying waste plastic is a perfect environmental solution.'

PowerHouse began work on its proprietary DMG system about three years ago. The company made major progress during 2017, including commissioning the prototype DMG unit at the University of Chester's Thornton Science Park and the signing of an agreement with Peel Environmental Ltd for the first commercial site, in Cheshire, for a DMG unit. Developing this site, and building and commissioning the first commercial unit, is one of the company's key objectives for 2018.

## THE BUSINESS MODEL

PowerHouse's business model is to build, own and operate DMG facilities in the UK. At each of these facilities, the company would receive a gate fee for receiving waste and then convert the waste into hydrogen and green electricity for onward sale. The production cost of DMG hydrogen would be about £3 per kilo, compared with a current hydrogen price of about £12 a kilo. In addition to owning its own DMG units, PowerHouse intends to seek partnering deals with local authorities, transport and industrial businesses and fuel cell vehicle manufacturers.

In continental Europe, PowerHouse estimates it could open 500 sites in the next 10 years and is also exploring the potential for the technology to be licensed worldwide. The company has taken the first steps in the export of the DMG system by signing a memorandum of understanding in Qatar to explore the possibility of establishing a Qatari DMG network to convert waste to hydrogen.

Keith Allaun says: '2018 will be a tremendously exciting year with the development of our first commercial DMG system on a site in Chester. We are on the threshold of delivering on our vision of kick-starting the hydrogen economy through a profitable business based on the eradication of waste plastic.

'Over €10bn has been committed to the rollout of hydrogen-fuelled transport by the likes of Mercedes, BMW, Toyota, Hyundai, and Honda over the next five years. Our ability to play a part in generating the cleanest fuel on Earth, in an economically advantageous and environmentally responsible manner, is unparalleled.'

# Servoca – staffing essential services

**Website:** www.servoca.com

Servoca's (SVCA:AIM) end markets include healthcare, education, criminal justice, domiciliary care and security. The majority of the revenue and gross profit generated (circa 80%) come from the group's recruitment activities which supplies temporary nurses, care workers, teachers, teaching assistants, investigators and probation staff. The group's outsourcing activities (around 20% of revenue and gross profit) include domiciliary care, which aims to meet the growing demand for care from an ageing and growing population.

## EXPERIENCED MANAGEMENT TEAM

The business is headed by CEO Andy Church, who has substantially and successfully restructured the group since joining in December 2008. He has overseen consistent year-on-year growth for the last six years and previously, as CEO of Lorien Resourcing, Church led a substantial turnaround of performance which led to revenues doubling from £100m to £200m over a three-year period.

Chris Hinton was appointed as CFO in November 2017 and

## WHO IS SERVOCA?

**AN ESTABLISHED RECRUITMENT AND OUTSOURCING SPECIALIST WHOSE BUSINESS IS FOCUSED IN THE SUPPLY OF PEOPLE AND SERVICES THAT ARE ESSENTIAL AND NOT DISCRETIONARY.**

5 Year financials

| Servoca | 2013 (A) | 2014 (A) | 2015 (A) | 2016 (A) | 2017 (A) |
|---|---|---|---|---|---|
| Year End September | £'m | £'m | £'m | £'m | £'m |
| **Group revenue** | **43.1** | **49.0** | **58.8** | **69.2** | **80.2** |
| % growth | 1% | 14% | 20% | 18% | 16% |
| **Gross profit** | **12.3** | **14.2** | **16.9** | **18.6** | **19.7** |
| % growth | 2% | 16% | 19% | 11% | 6% |
| % margin | 28% | 29% | 29% | 27% | 25% |
| **Adj. EBITA** | **0.9** | **1.8** | **3.1** | **3.6** | **4.0** |
| % growth | 223% | 102% | 73% | 17% | 10% |
| % margin | 2.0% | 3.6% | 5.2% | 5.2% | 5.0% |
| % conversion rate | 7% | 13% | 18% | 19% | 20% |
| **Adj. PBT** | **0.8** | **1.7** | **3.0** | **3.5** | **3.9** |
| % growth | 289% | 111% | 77% | 17% | 11% |
| % margin | 2% | 3% | 5% | 5% | 5% |
| **Adj. EPS (fully diluted)** | **0.56p** | **1.07p** | **1.88p** | **2.21p** | **2.53p** |
| % growth | 532% | 90% | 75% | 18% | 14% |
| | | | | | |
| **Net cash/(debt)** | **-3.1** | **-2.6** | **-2.0** | **-2.4** | **-2.3** |
| **Dividend** | **0.00p** | **0.00p** | **0.30p** | **0.35p** | **0.40p** |

Sources: Company data

brings with him extensive public company and recruitment experience, most notably from Lorien where he worked with Andy Church and John Foley (chairman) as CFO.

## TRACK RECORD OF GROWTH

Servoca has a strong track record of growth, with revenue, gross profit and adjusted pre-tax profit growing consistently year on year since 2012.
Over the past two years, the group achieved a compound annual growth rate (CAGR) in adjusted pre-tax profit of 14%. Growth has been primarily driven by Servoca's two largest end markets of education and healthcare.

## STRUCTURAL GROWTH IN END MARKETS WITH NON-DISCRETIONARY SPEND

The focus of the group is rooted in the supply of people and services that are essential and not discretionary. Servoca's end markets are underpinned by long term structural growth trends. Demand in education is supported by a growing pupil population and a shortage of teachers. The nursery and primary school pupil population has been rising since 2009 and this is now starting to impact secondary school pupil numbers which are projected to continue increasing year on year until at least 2025.
The growing and ageing population underpins growth in the healthcare recruitment and domiciliary care markets.

## DIVERSIFIED BUSINESS MIX

Servoca supplies to six distinct end markets and the group's diversified business mix has delivered a resilient performance.

The group has delivered substantial growth over the last five years despite parts of its operations facing challenges (mainly as a result of public sector funding pressures) from time to time. The healthcare operations benefit from exposure to all areas of the care 'life cycle' and operate in both the public and private sector. The group supplies staff into hospitals where demand remains at record levels however, through their domiciliary care business, also benefits from the clinical and economic necessity to free hospital beds and care for people in their own homes.

Remaining supply of staff is into residential care settings in the private sector which accounted for two thirds of operating profits within their healthcare recruitment businesses last year. As well as supplying schools with staff nationally from a network of 15 branches across the UK, the Group is also a major provider of temporary resource to the National Probation Service and the majority of police forces in England and Wales.

The security operation supplies services in manned guarding, event security, software and hardware solutions for loss prevention in the retail industry and also delivers corporate investigations work.

## ORGANIC AND ACQUISITIVE GROWTH

Over the last five years the majority of growth has been organic but management have experience of acquisitions, having made three since Andy Church became CEO. The two most recent acquisitions (2015 and 2016) bolstered Servoca's market share and geographic presence in the UK education recruitment market. Management has indicated that further M&A is a possibility both in its core markets and in complimentary sectors.

## STRONG MARGIN PERFORMANCE

At just under 5% last year, Servoca's operating margin compares favourably to the recruitment peer group (average of 4.1%, 3.4% excluding Page Group). Servoca has maintained a conversion rate (operating profit divided by gross profit) in excess of 18% over the past three years, alongside strong growth in net fee income.

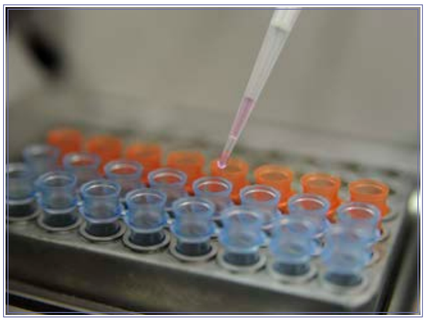
The substantial growth and financial performance of the last six years has strengthened the group's balance sheet and enabled the group to pay a dividend since 2015. The dividend currently reflects a 2% yield, has been increased by 33% since inception but was still covered more than six times by last year's earnings. Management expect to retain a progressive dividend policy.

Based on analyst forecasts, Servoca trades on a 2018 PE multiple of 7.7 times, falling to 6.9 times vs the peer group on 11.7 times, falling to 11.5 times.

Valirx
Bioscience Innovation

# ValiRx delivers according to plan

## Website: www.valirx.com



Worldwide, cancer is the second leading cause of death after heart disease. New technologies and tools have revolutionised the understanding of cancer and have allowed increasingly more specific approaches to the disease. From a technical point of view, it is reasonable to expect science to be able to one day, turn most cancers into either curable or chronic diseases. Caught early and with the right therapeutic approach, several cancers will be highly treatable.

**ValiRx (VAL:AIM)** is a clinical stage biotechnology company specialising in developing targeted novel treatments for cancer and associated biomarkers. It aims to make a significant contribution in 'precision' medicine and science, namely in the development of therapeutics, with the aim of breaking through into human health and well-being, through the early detection of cancer and its personalised therapeutic intervention.

Currently, the company has four therapeutic drugs in development, two of which are in clinical trials. Both clinical stage therapeutics and preclinical developments have demonstrated clear potential for addressing huge unmet medical needs. The Company has worldwide exclusive developmental and commercial rights and its compounds have worldwide patent protection. The technologies and science lying behind the development programmes and therapeutics, originate or derive from world-class institutions, such as Cancer Research UK and Imperial College.

Whilst established cancer treatments, such as surgery, radiation and chemotherapy, are still improving, the great excitement in the cancer arena today, lies in the development of novel and targeted therapies, otherwise known as 'Precision Medicine'. This targeted, personalised medicine includes early stage diagnosis of every specific cancer, tailor-made therapeutic intervention and the careful monitoring of progress. With the development of target-based agents, primed to attack only identified cancer cells, higher response rates for treatments, as well as less toxic and more effective outcomes, are now possible. New drugs in this group—such as those in ValiRx's pipeline—promise to greatly improve outcomes for cancer patients.

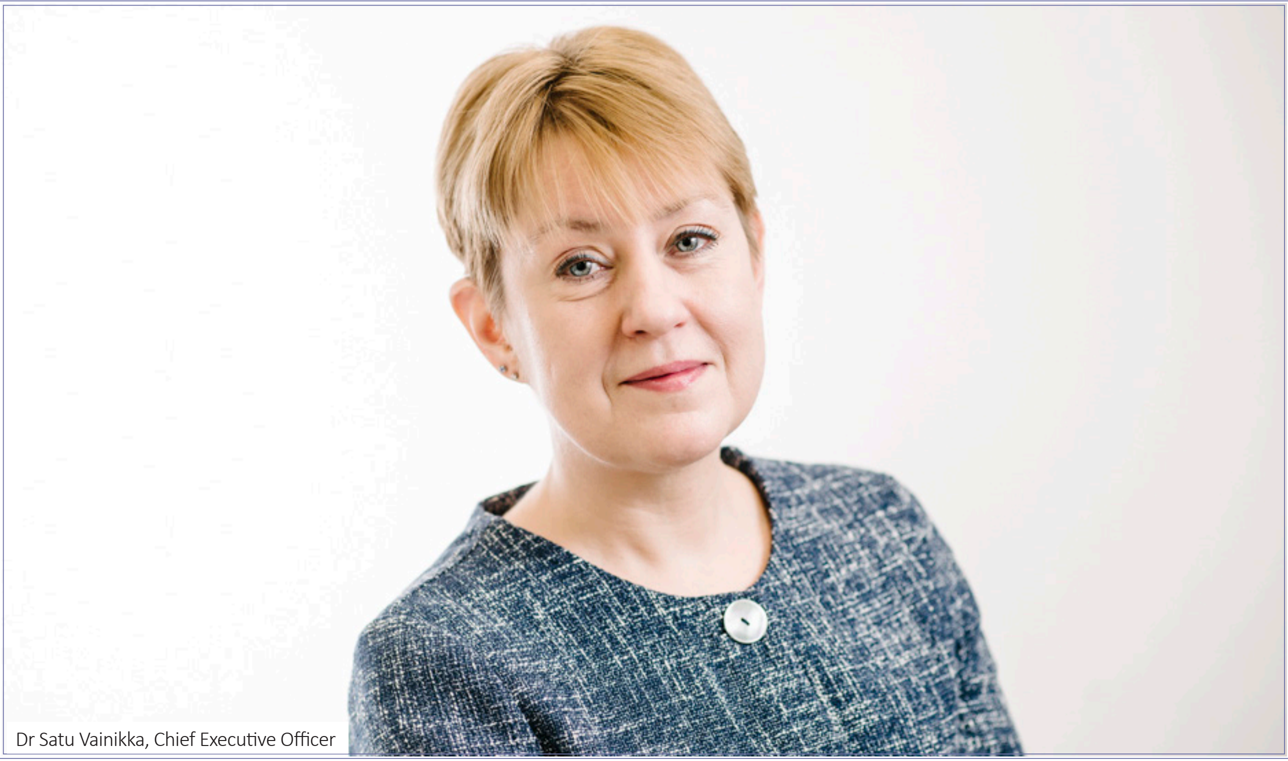
### WHO IS VALIRX?

**VALIRX IS A CLINICAL STAGE BIOTECHNOLOGY COMPANY SPECIALISING IN DEVELOPING TARGETED NOVEL TREATMENTS FOR CANCER AND ASSOCIATED BIOMARKERS**

## RECENT CLINICAL TRIAL PROGRESS AND EXCITING NEW DEVELOPMENTS

### VAL201

ValiRx's lead compound, VAL201, has the potential to treat hormone-induced oncological conditions and abnormal growth in cells, including prostate, breast and ovarian cancers, as well as Endometriosis. The compound is currently in Phase I/II clinical trials in patients with hormone-resistant prostate cancer at University College London Hospital. VAL201 is a compound with a unique mechanism of action, which was first discovered by



Dr Satu Vainikka, Chief Executive Officer

academics, partly with support from Cancer Research UK.

VAL201 has performed extremely well in its Clinical Trials and as confirmed to date, the compound is well tolerated and safe and has shown preliminary signs of efficacy.

Based on its excellent safety profile in first clinical trials, ValiRx received approval in December 2017 from the UK Medicines and Healthcare Products Regulatory Agency (MHRA) and the Research Ethics Committee (REC) to escalate the VAL201 study and to see a substantial increase in the dose of VAL201 being administered to patients, thereby allowing treatment to more speedily reach its full therapeutic potential and potential anti-cancer impact on patients.

A major challenge experienced in any cancer treatment is the ability of cancer cells to seek new locations and to spread to other sites in the body. This is called metastasis. The ability of cancer cells to metastasize is, as a rule, very bad news for cancer sufferers, as it offers the cancer cells potential new places in the body for growth. With this issue in mind, scientists at ValiRx have been very excited by what they have seen in a subset of the pre-clinical data obtained with VAL201, as it shows that the compound, when administered in cancer models, decreased metastatic growth by up to 50%. Since all cancers have the potential for metastatic growth, ValiRx believes that this treatment could potentially be used in several oncological indications, together with a specific cancer targeting treatment.

## VAL401

ValiRx's second drug currently in clinical trials is VAL401, which is a reformulated drug, Risperidone, with an established safety record derived from clinical studies and years of use in other medical areas. ValiRx's subsidiary, ValiSeek, has completed its first trial of VAL401 as an oral treatment of late stage non-small cell lung adenocarcinoma in a Phase II Clinical Study in Tbilisi, Georgia.

Positive VAL401 clinical data from the completed trial in December 2017 shows that the VAL401 treatment had a statistically significant improvement in Overall Survival for patients with non-small cell lung cancer compared to those receiving no treatment. In addition, further positive data from the results of this trial also showed that the VAL401 treatment had a measureable improvement on patient quality of Life. Furthermore, the compound did not trigger any unwanted immune responses

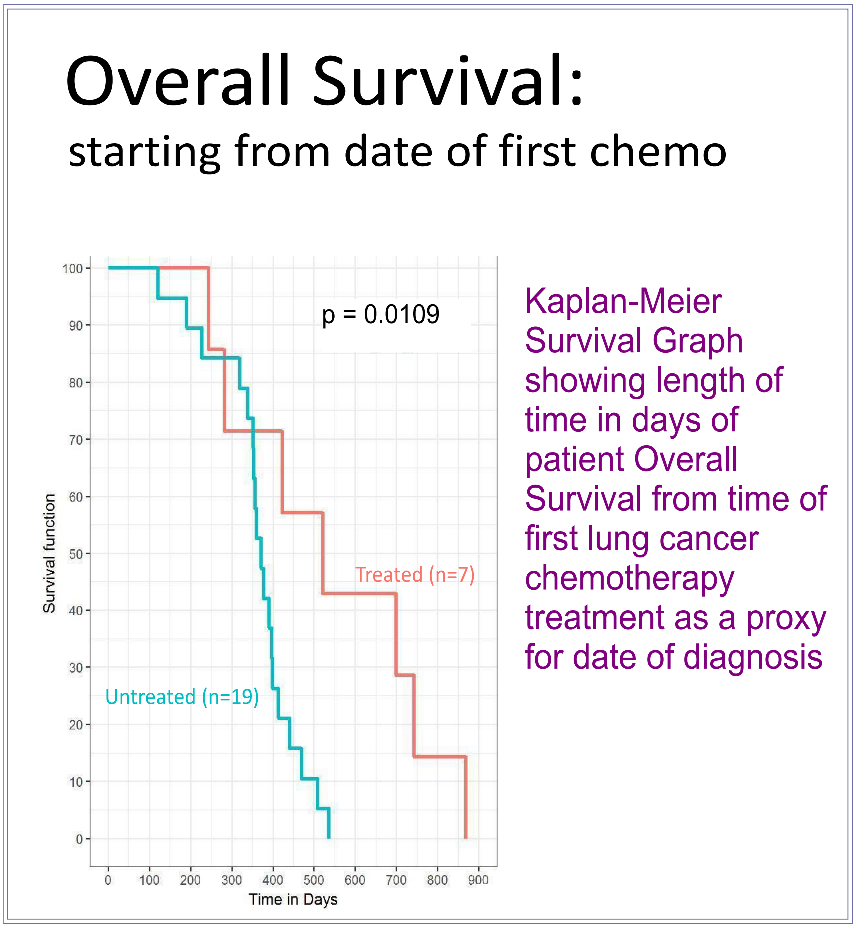
## VAL301

Preclinical studies of VAL201 have also revealed a major gynaecological indication for the compound, namely Endometriosis. This is a medical condition in which cells from the lining of the uterus appear and flourish outside the uterine cavity. Endometriosis is excessively debilitating, and it represents one of the major causes of female infertility. In preclinical studies, VAL201's reformulation, which has been named VAL301, has been shown to reduce the endometrial lesions by up to 50%. The condition is not adequately served with current medications, as those medications are frequently poorly tolerated. However, due to VAL201's safety profile and lack of any noticeable side effects, the compound is well placed as a potential treatment.

## VAL101

The molecule VAL101 is based on a technology, licensed from Imperial College, which is called GeneICE ('Gene Inactivation by Chromatin Engineering'). On the premise that all cells in our bodies contain the same genome and that tissue differentiation requires well maintained, highly-tuned specific gene activity regulation, if this regulation system goes wrong, or genes have unwanted mutations and are "rebellious", problems such as cancerous growth or neurological indications and problems will occur.

The GeneICE technology allows the design of molecules which find and bind these 'rebellious genes', thereby potentially reversing the problem. VAL101 is a molecule based on this technology and it is currently in pre-clinical trials.




## BUSINESS MODEL

The Company's business model focuses on in-licensing early stage drugs and technologies from World leading academic institutions, such as Cancer Research UK and Imperial College and maturing them to the point where they can be out-licensed to pharmaceutical partners or co-developed and taken to market. The model for biotechnology companies, like ValiRx, is to act as a specialised and experienced bridge between world-class academic science and big pharma, as pharmaceutical companies are facing an increasing need for novel, more precise and effective therapies across several indications. ValiRx strives to be in continuous discussions with these major players in the oncology field.

## THE NEXT STAGE AND INTO THE FUTURE

Given the current industry climate, ValiRx believes that in view of the progress of these trials, the company and its therapeutic approaches are increasingly attractive to pharma partners, as a licensing opportunity or a co-development partner.

As discussed above, the pharmaceutical industry is increasingly looking for novel therapies in the oncology arena and accordingly, in its view, ValiRx is entering a new and very exciting phase, which it believes should result in the crystallisation of substantial value.

Details about the trials can be found on the website: **www.clinicaltrials.gov**