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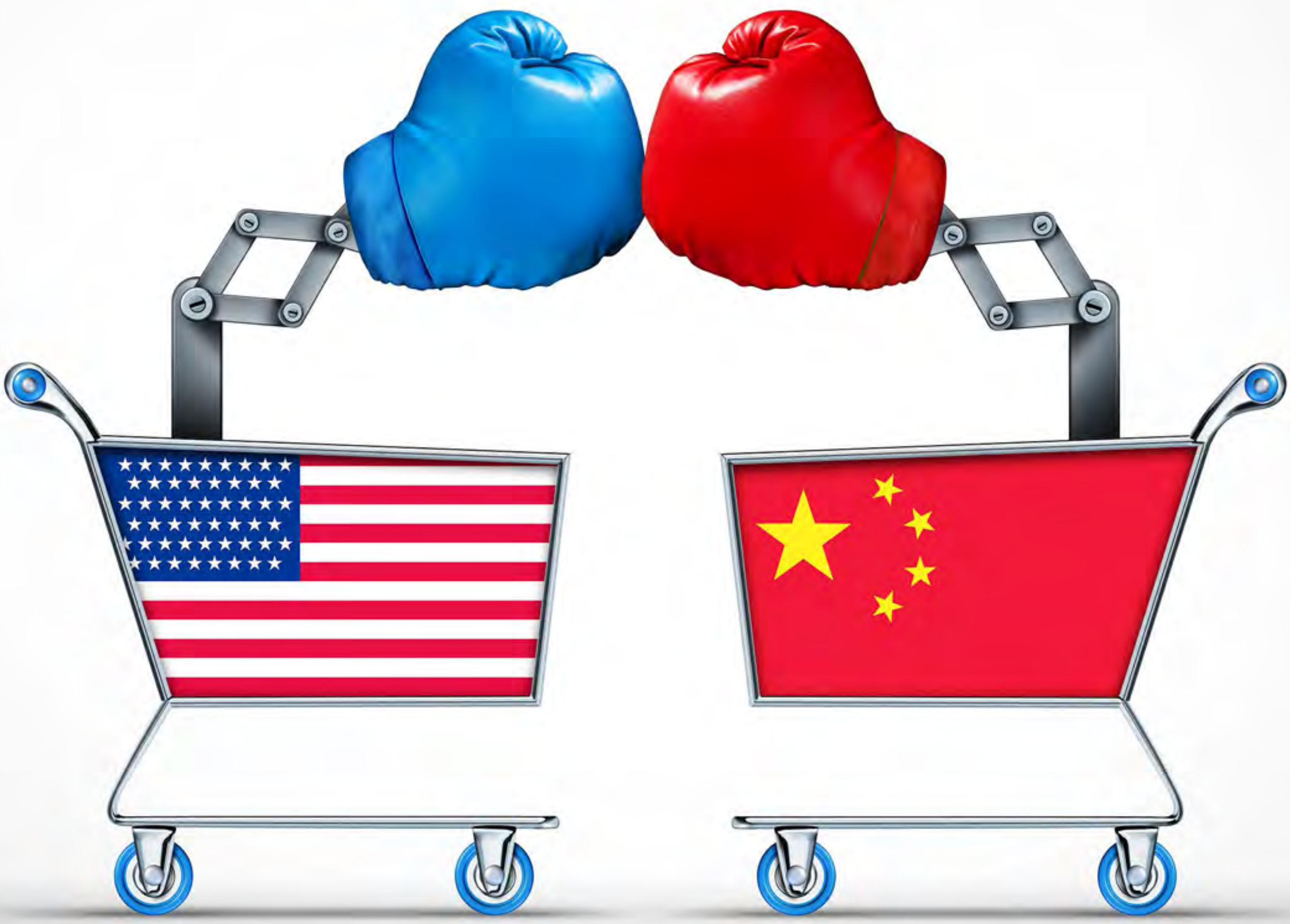
# SHARES

WE MAKE INVESTING EASIER

# TRADE WAR

## HOW COULD IT IMPACT YOUR PORTFOLIO?



CAN SHARES IN **TOBACCO COMPANIES** FIGHT BACK AFTER A TORRID TIME?

**THE BIG DECISION:** CUT YOUR LOSSES OR HOPE FOR A SHARE PRICE RECOVERY?

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INSIDE: **TESCO, GLAXO, MELROSE, HAMMERSON, UNILEVER, SOSANDAR** AND MORE

# Where next for platinum as the metal nears a 10-year price low?

There is an argument to suggest all the bad news in now priced into platinum miners' shares

One of the biggest stories in the commodities space at the moment is the collapse in the platinum price amid demand concerns.

The precious metal last week traded close to a 10-year low at $798 per ounce, compared with a $778 per ounce price recorded in October 2008. The latter was the result of the metal more than halving in value amid the global financial crisis.

Platinum spent the latter part of 2017 trading in a $900 to $1,000 range before the big decline this year.

The market is worried about a surplus of platinum and how a global trade war may also impact demand. Higher tariffs could make vehicles more expensive and lead to fewer car sales – something that is bad for platinum given its key role in catalytic converters.

The metal is already facing demand pressure from falling diesel car sales and expectations of a large pick-up in demand for electric vehicles over the next 10 years where catalytic converters won't be needed.

Many platinum miners in South Africa are expected to be loss making at the current metal price, yet the industry hasn't imposed widespread output reductions. There are political issues to consider as the country is unlikely to want to cut jobs in the sector.

At the moment the platinum sector doesn't seem as if it will adapt to changing market conditions by flexing supply as you would perhaps see in other commodity markets. If the price decline gets worse the industry may have no choice but to impose tighter supply controls, just like we saw in the oil sector a few years ago.

We've seen long-term forecasts for platinum in the range of $850 to $1,200. Investment bank Jefferies forecasts $900 per ounce for the rest of the year, implying a more stable price environment.

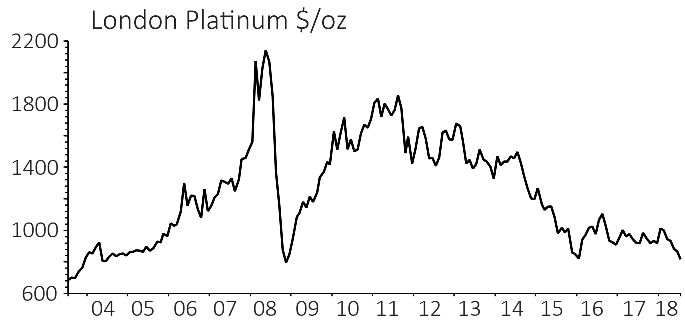
Investors with an appetite for high risk may therefore wish to look at UK-quoted platinum miners, particularly if you believe the market has already priced in current negative issues.

We see two obvious stocks to buy. **Anglo American (AAL)** is the most exposed to platinum group metals of the big diversified miners. You also get exposure to many other commodities as a cushion should platinum not play out as expected. A lot of its earnings are derived from iron ore, coal and nickel.

**Tharisa (THS)** has a large scale, low cost platinum group metals and chrome mine in South Africa. (DC)

| UK-LISTED PLATINUM MINERS SO FAR IN 2018 | |
|---|---|
| Sylvania Platinum | +29% |
| Anglo American | +3% |
| Tharisa | -10% |
| Jubilee Metals | -37% |
| Lonmin | -54% |

Source: Shares, SharePad



# COME TO LENDY COWES WEEK 2018 4th - 11th AUGUST

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# Contents

**VIEWING SHARES AS A PDF?**
CLICK ON PAGE NUMBERS TO JUMP TO THE START OF THE RELEVANT SECTION

# Can Jack's work its magic as Tesco's new discount chain?

The groceries goliath is rumoured to be launching a new discount brand

Reports suggest **Tesco (TSCO)** is about to launch a new discount chain named *Jack's* as part of wider efforts to combat competition from Aldi and Lidl.

We previously reported in February that Tesco was weighing up a budget format launch. It is now rumoured the *Jack's* fascia, named after Tesco co-founder Jack Cohen, could hit the UK high street in September.

Tesco, which recently announced a strategic alliance with France's Carrefour, is tight-lipped on the topic. If the story is true, the new sub-brand will be an estate of limited assortment discounters (LADs) better placed to compete head on with Aldi and Lidl.

Given ownership of Booker and its new Carrefour tie-up, Tesco is likely to have the buying power to make *Jack's* a success, although GlobalData retail analyst Thomas Brereton says this is a risky response to Aldi and Lidl, since 'orchestrating the emergence of a new brand without damaging the reputation of the main Tesco image will require pinpoint precision to succeed'.

Tesco last tried the discounter approach in the mid-1980s under *Victor Value*, but it was eventually abandoned, blamed on the undermining of the main Tesco brand.

'To us there is unlikely to be material downside from Jack's birth albeit whether he moves the dial for the group or the wider industry margins remains to be seen,' counters Shore Capital analyst Clive Black. Yet he does question whether Jack's can make a difference in a business of Tesco's gargantuan size.

'Sixty stores or so is not likely to move the dial for Tesco albeit if they are particularly challenged or commonly characterised outlets then perhaps a new fascia can make them more productive?', wonders Black.

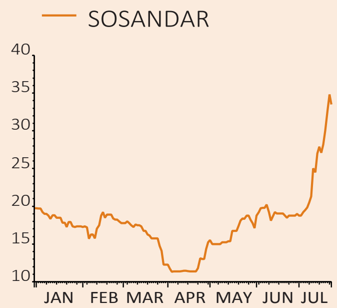
As CEO Dave Lewis is successfully simplifying Tesco, adding a new brand and associated capital expenditure requirement adds a complicating factor to the business. (JC)

## Sosandar is a rare retail success story in 2018 with soaring shares

### Online women's fashion brand has delivered spectacular gains for shareholders

THERE REMAIN bright spots in the retail sector. Shares in online women's fashion brand **Sosandar (SOS:AIM)** have more than tripled this year from 11.2p in April to 34.5p, as investors were wowed by the stellar growth rates flagged at the half year (29 Mar) and full year results (11 Jul).

Guided by joint CEOs Julie Lavington and Ali Hall, who previously ran fashion magazine *Look*, the Sosandar brand targets an underserved generation of women who have graduated from throwaway fashion and are 'looking for quality, affordable clothing with a premium, trend-led aesthetic'. (JC)



# Renewed speculation that GlaxoSmithKline could spin off consumer division

Reports suggest chairman Philip Hampton is sounding out shareholders about a corporate break-up


Pharmaceutical giant **GlaxoSmithKline (GSK)** is once again in the spotlight about potentially spinning off its consumer division to unlock value in the business and have a tighter focus. The demerged entity would focus on such brands as *Sensodyne*, *Piriton* and *Panadol*.

UBS analyst Michael Leuchten says a break-up of the business makes sense and highlights the consumer business only generates approximately 20% of group earnings.

Citi is more sceptical, arguing the apparent reassessment of a break-up is an attempt to 'buy time and support the recently rebounded share price'. The shares are up 18% so far this year.

The investment bank highlights any strategic review is not a commitment to breaking up the business and the speculated two to three year timeline 'may as well be an eternity'.

According to media reports, Glaxo's chairman Philip Hampton has been talking to large shareholders about creating a more focused pharma and vaccines company. Achieving this task may require an improved performance from the pharma operations which have lagged the peer group in terms of developing new blockbuster drugs.

In the first quarter of 2018, pharma sales increased by 2% to approximately £4bn once currency changes were stripped out, driven by growing sales from its HIV drug portfolio.

Sales in the consumer healthcare division were also up 2% to £2bn although this pales in comparison to a 13% surge in vaccine revenues to £1.2bn.

Chief executive Emma Walmsley last year brought in drug development expert Hal Barron as the company's new chief scientific officer. He is expected to drive the performance of the pharma division by boosting spending.

In March, the company bought out its 36.5% consumer healthcare joint venture partner Novartis to obtain full control.

In the same month, GlaxoSmithKline also decided not to bid for Pfizer's consumer assets, which may have been a relief to investors as debt would have risen significantly had it done the deal and put the dividend at risk.

Despite walking away from the Pfizer assets, the company does have its sights set on other acquisitions, particularly those that specialise in blood cancers, according to reports.

Walmsley says any acquisitions must meet GlaxoSmithKline's criteria for returns and not compromise the company's capital allocation priorities. (LMJ)

# Asset valuation concerns cloud Hammerson as it seeks £1.9bn disposals

The retail property investor wants to offload a lot of properties... but will it get a good price?

Property group **Hammerson (HMSO)** wants to sell £1.9bn worth of assets by the end of 2019 as it tries to streamline its focus on flagship retail destinations and premium outlets.

It intends to exit all retail parks over the medium term and won't go ahead with expanding the Brent Cross shopping centre for now, citing heightened market risks.

The new strategy will also see it obtain greater geographic diversification with non-UK retail exposure increasing by approximately 10%.

The big concern for investors is that asset valuations will have to be marked down, particularly as Hammerson is now seen as an eager seller of properties and so potential buyers may try to strike a bargain. Ongoing retail sector weakness is also likely to lead to lower asset values.

The company earlier this week sold two retail parks for £164m which is 10% below book value.

Stockbroker Numis says Hammerson is entering a period of 'heightened execution risk' and it sees limited reason to invest in the shares at present.

The broker has particular concerns about Hammerson's UK shopping centre assets, where the market is much less liquid and where values haven't been written down significantly yet. (DC)

## Shareholders rally to block excessive pay packages

### The revolt at Royal Mail is the latest in a string of challenges against UK-listed firms

SHAREHOLDERS ARE increasingly blocking excessive pay packages with the latest example being **Royal Mail (RMG)** where 70.2% voted against the directors' remuneration package.

New chief executive Rico Back is being paid a £640,000 annual salary, which is 16.8% higher than his predecessor Moya Greene who stepped down as CEO on 1 June and leaves the company in September. Greene has also been awarded a £900,000 termination bonus.

Royal Mail non-executive director Orna Ni-Chionna says the firm does not feel it is appropriate to cut the salary for a 'very demanding role,' flagging Back's pension entitlement is lower than Greene's and that both individuals essentially have the same combined base salary, pension entitlements and benefits.

In May, 58.5% of shareholders voted against directors' pay at British satellite telecoms firm **Inmarsat (ISAT)**.

Other high-profile spats include 52% of shareholders at gold miner **Centamin (CEY)** voting against higher pay at its AGM in March.

Self-storage provider **Safestore (SAFE)** suffered a rebellion four months ago with nearly half of shareholders revolting against £14m in share awards for its chief executive and finance director. (LMJ)

# Snap up Melrose now before it updates on GKN value creation goals

Analysts suggest you could make 30% share price gain in a year plus possible cash returns on top

Buy it, fix it, build it, flog it: this is **Melrose Industries' (MRO)** business model mantra in a nutshell. We think now is a superb time to buy the shares.

The £10.3bn FTSE 100 turnaround specialist operates more like a private equity firm than a traditional company. The manufacturing-focused entity has also been called an asset stripper by less charitable market watchers but its ethos has little in common with corporate raider Gordon Gecko, that cold-eyed wheeler dealer from Oliver Stone's film *Wall Street*.

**MELROSE INDUSTRIES ↗ BUY**
(MRO) 218.5p
Stop loss: 175p

Market value: £10.3bn

## WHAT DOES IT DO?

The recipe for success is not complicated. It streamlines acquired businesses, stripping out duplicated and unnecessary costs, which bolsters profit margins and cash flows. This efficiency and improvement is gradually picked up by investors, creating more appetite for the stock and driving a higher rating for the share price.

As cash builds on the balance sheet from business sales Melrose doesn't just sit idly on the readies, it hands back surplus cash to investors. Since 2007 it has returned cash on five occasions worth a combined 463p per share.

Melrose is now facing the biggest challenge in its 15-year history, having finally won the £8.1bn bitter battle for control of UK auto and aero engineer GKN, ending 260 years of independence.

But out of adversity comes opportunity, setting up what investment bank JP Morgan calls an 'attractive multi-year equity story'.

The most optimistic analysts believe you could make 30% share price gain in the next year, plus a good chance of significant cash returns too.

## TRIED AND TESTED IMPROVEMENT

There are very good reasons why Melrose won the support of GKN's shareholders, not least because the target company had been stumbling along for years.

In contrast, Melrose has an excellent track record of creating shareholder value using its 'Buy, Improve, Sell' model to identify underperforming assets, drive improved performance and then sell the assets on, returning the proceeds to Melrose shareholders.

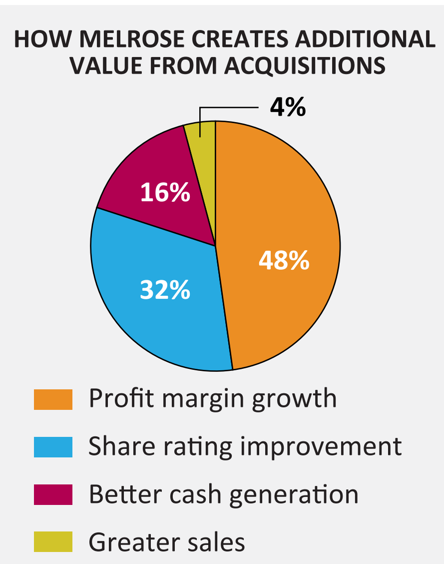
The company has paid out big in the past. It has pulled off a small handful of deals for targets valued at £1bn or more, including the £1.8bn purchase of gas, electricity and water flow measurement firm Elster in 2012.

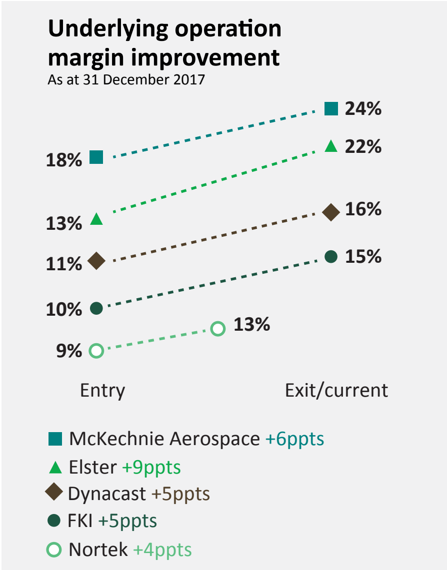
This was eventually sold to Honeywell at the end of 2015 for £3.3bn and triggered a £2.4bn cash return to Melrose shareholders. That's an impressive achievement in barely three years.

In 2016, Melrose shelled out £2.2bn for air management and home automation engineer Nortek, an asset still under the Melrose wing. But perhaps not for long now that management time and energy is needed for GKN's rehabilitation.

Analysts at Deutsche Bank reckon Nortek's Ergonomics arm could be sold before the end of this year, potentially for £787m. While those proceeds are more likely to go towards paying down some of the £3.4bn net debt estimated for the end of 2018, it'll likely be a different story when Nortek's security and air management divisions go, probably sometime next year.

Possibly part of a joint deal, Deutsche Bank's analysts reckon the businesses could raise




£3.1bn, a good chunk of which could be handed back to Melrose investors.

## IMPROVEMENT AT THE MARGINS

The main way Melrose plans to boost GKN's returns is by improving profit margins, the key focus for the next two or three years. And there is substantial scope to do just that.

Numis analysts calculate that operating profit margins of 9% to 10% are quite achievable at GKN's main auto business, Driveline. They are currently running at about 7%. On the aerospace side Numis anticipates 13% to 14% margins, an ambitious jump from 2017's underlying 7.8% run rate.

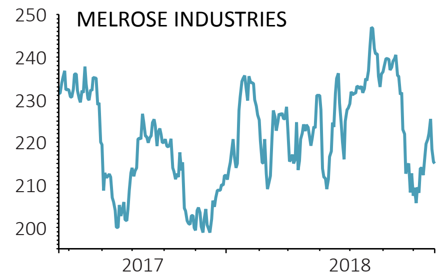
Encouragingly for new and existing investors, Melrose seems to already have a very clear picture of the problems to be solved, their scale and the solutions.

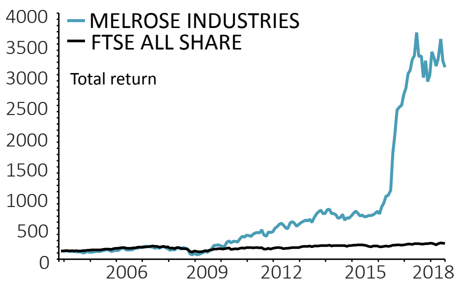
This includes sorting out operational shortcomings in the loss-making US Aero arm, and changing the commercial culture at Driveline, from simply chasing volume to concentrating on profit and cash.

Other challenges include managing a pension scheme in deficit inherited with GKN, not allowing restructuring charges to run amok and managing the typically extended sales cycle, all while aiming to lower debt. This is pretty much business as normal for Melrose, just on a bigger scale.

While the GKN turnaround is pitched on a three to five year basis we believe that the share price will begin to react once Melrose management have spelled out the scale and scope of targeted financial upside, scheduled for September. That could act as a catalyst for the stock and is a very good reason to invest in the Melrose story now. (SF)

**BROKER SAYS: 10 1 0**




**Melrose floated on AIM in October 2003 as a £13m buy-and-build cash shell. Fifteen years later it is in the FTSE 100 and worth £10.3bn.**

# Why investors are wrong to jilt McBride

Contrarians should pounce on the private label household goods-to-personal care products supplier


We're making a bold contrarian call on private label household-to-personal care products supplier **McBride (MCB)** following a pair of profit warnings earlier this year.

Restructuring has left it a much simpler business with a clearer focus and one that is more attractive to retail partners. There is also private equity interest in the private label operator space.

Its stock trades on a mere 9.2 times forecast earnings for 2019 and offers a 3.6% prospective dividend yield.

Net debt at the end of 2017 was £122.8m which is roughly half of its market cap. Yet it is worth noting that McBride recently agreed a deal to sell its European Personal Care liquids business for £12.5m with the money earmarked to help reduce borrowings.

**MCBRIDE BUY**
(MCB) 139.4p
Stop loss: 100p

Market value: £250m

## WHAT DOES IT DO?

McBride is a leading developer and supplier of products for sale under retailers' own brands, often referred to as private labels or own labels.

These span everything from toilet cleaners and laundry products to shower gels and toothpastes and are supplied to Europe's leading grocery retailers.

Previously an over-complicated, over-indebted concern with too many customers, McBride's margins and growth prospects have been materially improved under the stewardship of CEO Rik De Vos.

McBride recently flagged weaker-than-expected sales in May and June and some additional costs from new business wins.

Household revenues in France continued to decline, the Personal Care and Aerosols (PCA) arm will deliver higher than envisaged losses amid sales weakness, while McBride also flagged an impact from higher distribution and warehousing costs, largely connected with new German volumes.

In light of these issues, investors should only buy the shares if they have a large appetite for risk and money they can afford to lose. Profit warnings often come in threes, so we cannot rule out a further shock to the share price near-term.

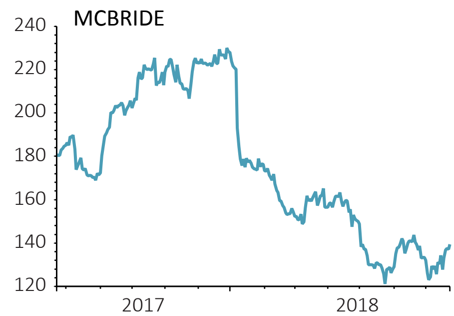
Encouragingly, McBride reported better-than-forecast sales in Germany and from acquired auto-dishwash-to-laundry products supplier Danlind, which has brought exposure to the fast-growing dishwasher tablets market and a range of Nordic customers.

The Manchester-headquartered concern is better placed to profit from the structural growth in private label and contract manufacturing and to continue to bag business from weaker competitors.

Down-trading by cash-strapped shoppers to cheaper private label offerings is boon for McBride, as is the trend towards contract manufacturing, as brand owners seek to drive improved financial performance.

Numis analyst Damian McNeela argues the shares look attractive 'with or without a suitor'. He forecasts a drop in pre-tax profit to £31.7m for the year to June 2018 (2017: £34.6m), before surging to £38.8m in 2019. (JC)

**BROKER SAYS: 4 1 1**



## UNILEVER
(ULVR) £43.40

### Gain to date: 2%

**Original entry point:**
**Buy at £42.53,** 2 November 2017

SHARES IN **UNILEVER (ULVR)** hit a nine-month high after second quarter results beat expectations and there was confirmation that it would buy back €3bn of shares between 20 July and the end of 2018. It has already spent the same amount on share buybacks in the first half of its financial year.

A 7.8% rise in underlying earnings per share to €1.22 was approximately 3% higher than forecast thanks to modest sales growth and a better operating margin.

'With 2.2% volume growth in the first half, Unilever's volume growth is firmly ahead of the market and global peers,' says investment bank Berenberg.

'We think Unilever has taken the biggest steps among peers to increase its agility, reduce costs, embrace digital channels and future-proof its portfolio, which is not reflected in the valuation. The 24 acquisitions since 2015 have added €3.5bn sales and are on track to boost organic growth by 100 basis points by 2019.'

Shareholders will be called to vote in late October on the Anglo-Dutch company's plan to scrap its dual-headed legal structure. If approved, the company is widely expected to leave the FTSE 100 index as a result of basing itself in the Netherlands as a Dutch entity.


**SHARES SAYS:** ↗
**One to own for the long-term. Keep buying. (DC)**

**BROKER SAYS:** 8 8 0

## DOTDIGITAL
(DOTD:AIM) 94.9p

### Loss to date: 2.2%

**Original entry point:**
**Buy at 97p,** 21 December 2017

WE COULD BARELY have called **DotDigital (DOTD:AIM)** better when we recently said an imminent trading update 'may well be the catalyst to put investor concerns to bed'.

The bulletin on 19 July indeed confirmed more robust growth, profits bang in line with expectations, an 18% increase in average revenue per user (ARPU) and, hopefully, an end to longer-run growth worries on new GDPR data protection rules.

The digital marketing tools supplier effectively confirmed that the strong progress was right across the board, although burgeoning US and Asia-Pacific regions were real standouts, revenue up 43% and 85% respectively.

This fed investors a clear sense of relief and led the share price to jump more than 20% on the day, and the stock has kept climbing since.

This suggests to us that full year results in October could spark further demand for this fast-growth investment story.

In the meantime, don't rule out acquisitions as the company is keen to add extra technology tools, customers and geographic footprint. Its seamless integration with Comapi, its first purchase, bodes well.


**SHARES SAYS:** ↗
**Now free of the GDPR concerns that have bogged the stock down for most of 2018, DotDigital has scope to run fast and far as investor optimism once again returns. (SF)**

**BROKER SAYS:** 1 0 0

# FUTURE

## (FUTR) 500p

### Gain to date: 26.6%

**Original entry point:**

**Buy at 394.88p,** 21 December 2017

Specialist media outfit **Future (FUTR)** has announced a discounted rights issue to fund the acquisition of the bulk of Purch, the publisher of online computer hardware magazine *AnandTech*.

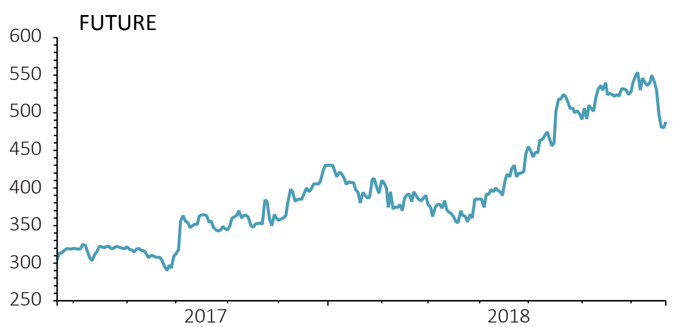
The $135.2m deal is being funded by a £105.7m fully underwritten rights issue at a 30% discount (based on the theoretical ex-rights price).

The acquisition will significantly expand the company's footprint in the US and Future will look to integrate Purch's publishing assets into its transferable platform. This makes money out of content through licensing, e-commerce and digital advertising. The transaction also brings in a separate advertising technology platform.

The company's recent track record of getting value out of acquisitions is impressive but this is a step up in scale and as such may prove to be a slightly more complicated task.

However, we are willing to keep faith and look forward to an update on the integration process alongside full year results in November.

The business will first need to secure approval for the rights issue at a meeting on 5 August.




**SHARES SAYS:** ↗

**Short-term pain could be replaced by long-term gains. Take up the rights issue and buy more stock. (TS)**

**BROKER SAYS:** 1 0 0

# DALATA HOTELS

## (DAL) 634p

### Gain to date: 9.2%

**Original entry point:**

**Buy at 580.5p,** 3 May 2018

WE'RE VERY CONFIDENT about the outlook for Irish hotel operator **Dalata Hotels (DAL)** given that revenue per available room (RevPAR) in the Irish hotels industry continues to beat expectations.

Since entering our *Great Ideas* portfolio, shares at Dalata have jumped 9.2% to 634p.

RevPAR, a key performance measure in the hotel industry, grew by 8.4% in Dublin and 11.4% in regional Ireland in June according to data from STR.

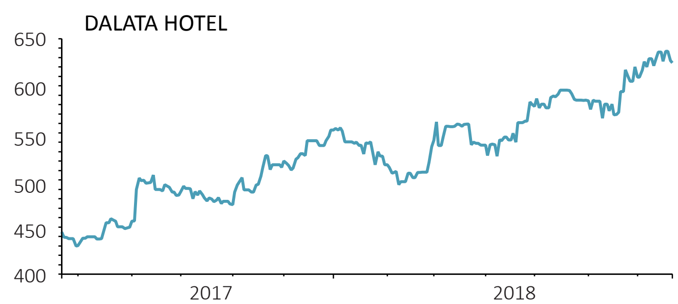
While this is slightly slower compared to May, the strong performance is still smashing forecasts.

Davy Research analyst Joseph Quinn anticipates RevPAR growth in Dublin of 5.5% for the year and 5% growth in regional Ireland.

Quinn says Dalata should continue to outperform the market with its strategy to improve its yield using decentralised sales management.

Outside of Ireland, Dalata has delivered 1.7% RevPAR growth in London in June thanks to the first hike in occupancies year-on year since May 2017.

The hotel operator is expected to outperform its UK-quoted peer, Premier Inn owner **Whitbread (WTB)**, with an anticipated annual 3.5% like-for-like rise in UK RevPAR according to Davy estimates. The broker only forecasts Whitbread to deliver a 0.5% increase in RevPAR over the same period.




**SHARES SAYS:** ↗

**We are encouraged by Dalata's continued outperformance in Ireland and robust trading in the UK. Keep buying. (LMJ)**

**BROKER SAYS:** 3 1 0

THIS IS AN ADVERTISING PROMOTION

# Positive outlook for the biotech sector

Geoffrey Hsu of OrbiMed Advisors LLC, the Portfolio Manager of The Biotech Growth Trust PLC, talks about the latest opportunities for the biotech sector


Geoffrey Hsu – Portfolio manager of the Biotech Growth Trust PLC

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# TRADE WAR

## HOW COULD IT IMPACT YOUR PORTFOLIO?

*BY STEVEN FRAZER*

Talk of escalating trade tensions is widespread and this is very important to investors. There is increasing concern that tariffs imposed on a swathe of overseas goods by US president Donald Trump, and Chinese retaliation, threaten a bruising time for a range of shares, funds and other assets owned by investors around the world including the UK.

As the US and China hurtle toward a fully-fledged trade war, so the spectre of stagflation, rapidly rising interest rates and even recession will loom increasingly large in the minds of investors as doubt is cast over corporate investment and global consumption in the months ahead.

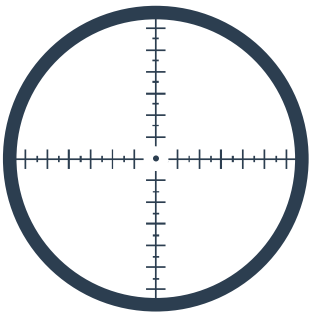
For now, the UK stock market is refusing to play ball. At 7725 (24 July) the FTSE 100 index gives the impression of rude health. At current levels the leading benchmark is trading as high as at any time during 2017, and is just 53 points, less than 1%, off its 7778 all-time high hit in January this year.

**TRADE WAR: IMPACT ON INVESTORS IN A NUTSHELL**

Stock markets are not yet fully discounting a trade war scenario, says UBS.

It envisages more than 20% downside for major markets in the US, Europe and Asia.

It suggests an all-out trade war would lead to a decline in global growth and a rise in global inflation. Corporate earnings could fall and therefore stock markets would be hit.



But against a backcloth of rising US interest rates, slowing European Central Bank stimulus, Brexit chaos and more, this is an extra problem investors do not need.

So what does the fall-out over global trade mean for investors and their portfolios, what measures can be taken to protect yourself, and where might pockets of opportunity emerge?

In this article we have surveyed the opinions of several economists, market strategy and portfolio management experts to answer these questions.

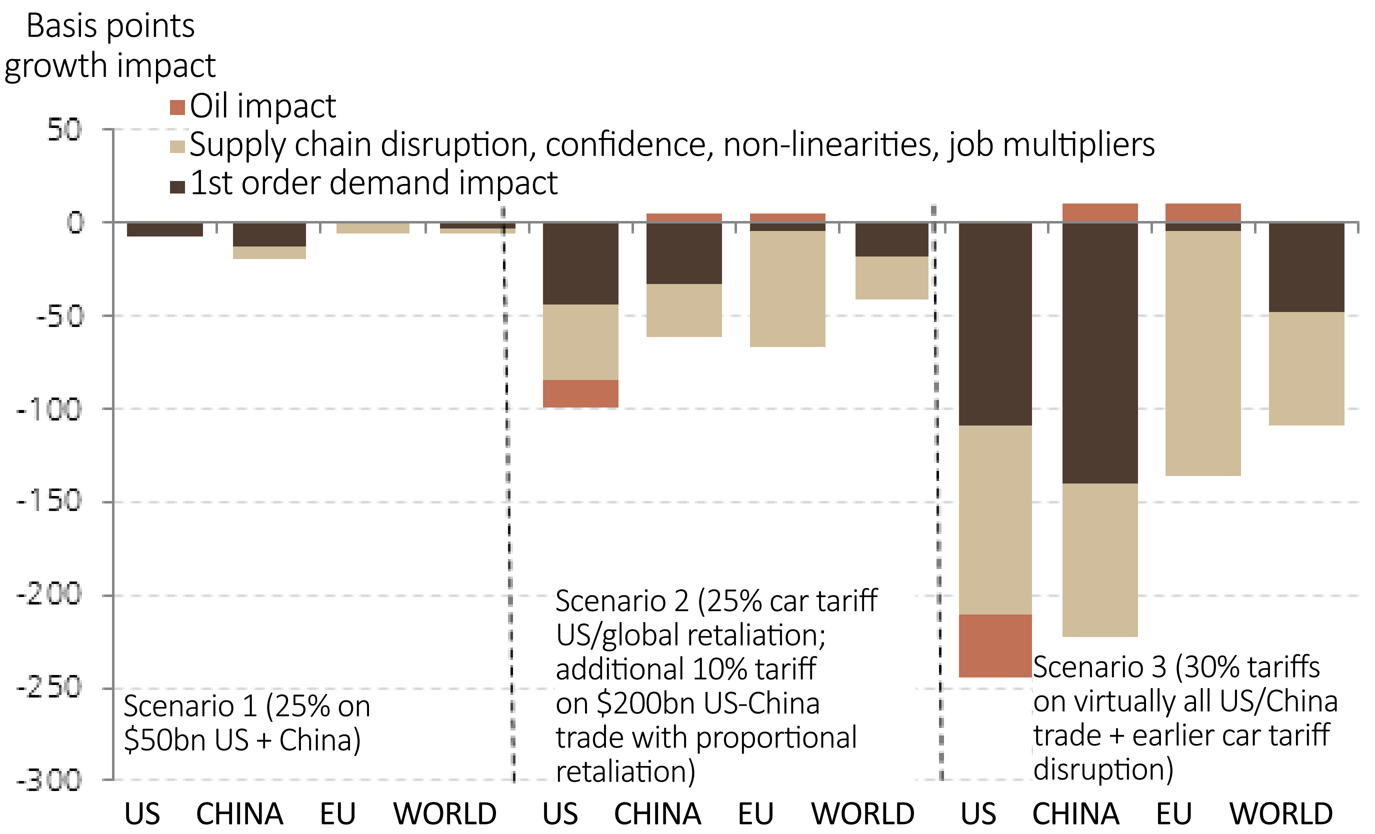
**THE STORY SO FAR**

Fresh from the US starting to impose tariffs on $34bn worth of Chinese goods on 6 July, and China responding in kind, the two countries attempted to negotiate a solution but failed.

The attempt instead resulted in Washington proposing fresh tariffs on another $200bn of Chinese imports and China saying it had no choice but to 'fight fire with fire'.

The situation keeps escalating.

## Growth impact different tariff scenarios




Source: UBS

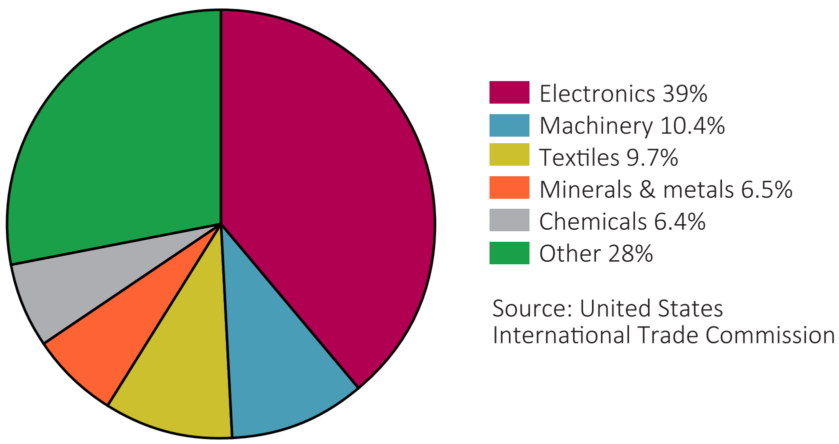
> **Free trade increases wealth and forces countries to specialise and divert resources to industries with comparative advantages**

Trump last week threatened to impose tariffs on all $500bn of Chinese goods entering the US.

What started out as controls on steel and aluminium has now been expanded to include an array of consumer goods, from vaping devices and mattresses, to handbags and digital cameras.

Electronics, machinery and textiles are some of the most popular US imports from China by value, according to 2016 statistics from the United States International Trade Commission.

### BREAKDOWN OF IMPORTS TO THE US FROM CHINA




Source: United States International Trade Commission

### DOES THE POLITICAL AND ECONOMIC CHAOS MATTER?

It's incredibly hard to know how the economic and political events around the world will play out. What we do know is that this is a very complex issue because trade statistics can be bent to fit any agenda, leaving room for possible

manipulation of the data.

According to Saxo Bank, global trade has grown by an average 4.2% a year during the past 215 years, a 6,437-fold increase. That's in spite of a whole host of awful events unfolding that set back trade, not least the two world wars.

'The long-term trend underscores what economists have known for centuries – free trade increases wealth and forces countries to specialise and divert resources to industries with comparative advantages,' says Saxo Bank's Peter Garnry.

When a country runs a trade deficit on a particular item, such as steel, it is because the country's steel industry is not competitive on the global stage, presuming there are no other factors to tip the scales. This is the basic principle behind free trade.

By importing items produced more cheaply in another country, the home country can divert its resources to those sectors where they have a competitive advantage, adding to overall wealth.

In Garnry's view, this is exactly why Trump and the US protectionist stance over steel production is folly. 'The vast wealth increase [in the US] over the past three decades has come from industries such as semiconductors, software, biotechnology, healthcare equipment and finance,' he says.

## NO WINNERS FROM A TRADE WAR

'Tariffs and protectionism benefit no one, especially given the global nature of business,' says Miles Eakers, chief market analyst at fintech company Centtrip.

This is a widely held view among economists, investment analysts and fund managers because the downside to the global economy is stark.

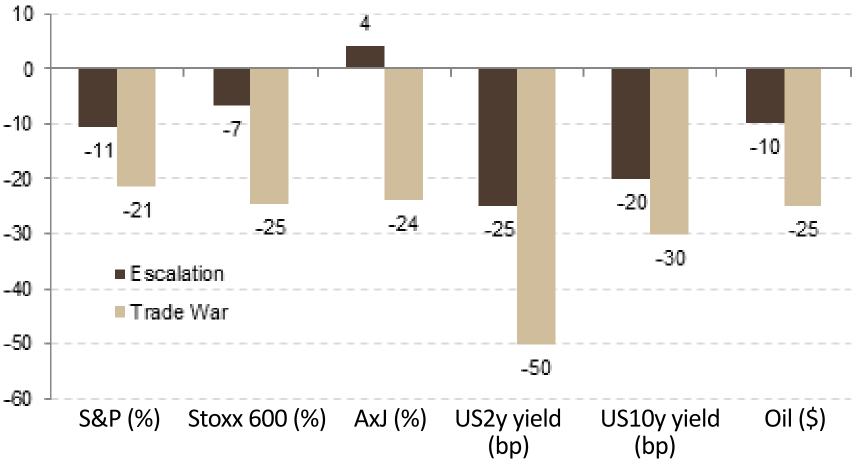
'We expect this will have a meaningful impact on US consumer inflation as well as a meaningful drag on US GDP growth,' says UBS economist Robert Martin, citing the Chinese government's pledge to retaliate against new US duties. 'China is by far the largest provider of consumer products to the US.'

Following the enactment of 1930 Smoot-Hawley Tariff Act, the US saw its imports and exports collapse by more than 60% between 1929 and 1933.

'This arguably made the

**"Tariffs and protectionism benefit no one, especially given the global nature of business"**

### POTENTIAL IMPACT ON FINANCIAL MARKETS




Source: UBS

Great Depression worse, and had considerable geopolitical consequences in the following decade,' says Tai Hui, chief market strategist at JP Morgan Asset Management.

It didn't do stock market returns any good either. Between 1928 and 1953 the S&P 500 index returned an average 1.3% a year (excluding dividends), according to Bloomberg data. That's a very low return for equities historically, and 'even including dividends, the return is around half of the historical trend,' says Saxo's Garnry.

History also suggests that restrictions on trade tend to really hurt the countries that impose them. For example, tariffs slapped on Japanese auto exports by the Ronald Reagan administration in 1981 led to 60,000 job losses in the US. However, that episode avoided escalating into a full-blown trade war and the impact on the US stock market was minimal.

**LITTLE DAMAGE SO FAR**

So far the negative consequences of the trade war posturing has had a limited impact on growth, although it is early days.

Prolonged tit-for-tat actions could affect economies in two ways. First is the impact on confidence, which could lead companies to delay investment and spending. Second is the direct impact of tariffs as they push up costs and depress end demand. The breadth and depth of global supply chains will amplify this impact.

'We observe that the prices of some US imports have increased significantly, such as washing machines, whose prices have increased by 20% over the past two months, but the overall effect is still marginal,' says Christopher Dembik, head of macro analysis at Saxo Bank.

## MIRABAUD'S BEST/WORST STOCKS FOR A TRADE WAR

Buying or selling stocks based solely on their exposure to some future disaster that has yet to materialise is not a terribly sensible way of investing. But understanding the scale of exposure a stock might have to any escalation in trade war manoeuvres could come in handy.

The strategy team at banking group Mirabaud have cast their screening tools over the entire Stoxx 600 index of UK and European companies. The exercise is designed to highlight what Mirabaud believes are safer haven stocks if trade war guns really start blazing, thanks to their home market focus, inexpensive valuation and, ideally, providing services rather than goods.

It has a second list of companies with high overseas markets, largely selling goods and currently trading on 'punchy valuations' which can be considered as stocks to fear.

'If international trade clogs up, then simple common sense favours domestic businesses involved in providing a service over those with a broad global footprint selling stuff,' says the Mirabaud strategy team.

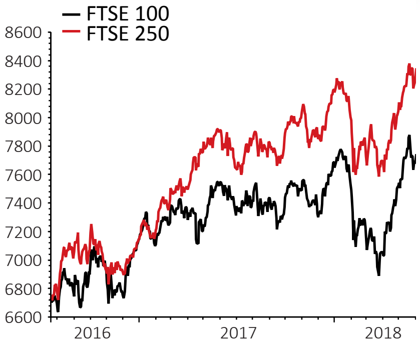
**EXAMPLES OF COMPANIES WITH DOMINANT UK EARNINGS**

| Company | UK revenue |
|---|---|
| Moneysupermarket (MONY) | 100% |
| Howden Joinery (HWDN) | 100% |
| SSE (SSE) | 100% |
| Whitbread (WTB) | 96% |
| Marks & Spencer (MKS) | 89% |

**EXAMPLES OF COMPANIES WITH LARGE AMOUNT OF NON-UK EARNINGS**

| Company | Revenue | | | |
|---|---|---|---|---|
| | Europe | Asia-Pac | Americas | Rest of the world |
| Renishaw (RSW) | 29% | 46% | 21% | 4% |
| Rotork (ROR) | 43% | | 28% | 29% |

Source: Mirabaud




**FTSE 100 VS FTSE 250**

Although the FTSE 100 is currently close to record highs, the UK has actually been one of the worst performing developed markets in the two years since the Brexit referendum given weak macro and political uncertainty. What's clearer is that the FTSE 100 is far more international, reliant on exports and overseas revenues, and complex international supply chains to manage.

The UK blue-chips are also massively exposed to commodity markets, where the FTSE 100 index is heavily populated by oil, gas and mining at the upper end of the market cap spectrum.

This situation arguably favours more domestically concentrated FTSE 250 companies in the short-term, which makes them more insulated from global trade wars, albeit not all immune.

'We expect the FTSE 250 to offer more upside opportunity given the ongoing political uncertainties surrounding trade tariffs,' says WisdomTree associate director Aneeka Gupta.

**NIPPED IN THE BUD**

'On trade, it is difficult to read Trump's intentions, but forthcoming mid-term elections, his love for a deal, and the fact that US corporations and unions are starting to grumble about the negative consequences for US jobs seem to suggest there should be a desire on all sides to de-escalate tensions over the summer,' says Ed Legget, who runs the **Artemis UK Select Fund (B2PLJG0)**. That inspires hope for investors, and eases the pressure of trying to second-guess the future.

> **The UK has actually been one of the worst performing developed markets in the two years since the Brexit referendum given weak macro and political uncertainty**

'We are especially sceptical of anyone trying to position for these events in advance as it rarely adds value to portfolio returns,' says Cyrique Bourbon, multi-asset portfolio manager for Morningstar Investment Management.

The bigger opportunity seems to be in assessing valuations in equity and bond markets in a world where investor sentiment can appear complacent.

'It's always difficult to predict the timing and catalyst for any strength or weakness but we are not forecasting some imminent or catastrophic decline,' says Bourbon. Avoiding recession is in everyone's interest.

## MID-WYND: HOPING FOR THE BEST, ANTICIPATING THE WORST

The investment team at **Mid-Wynd International Investment Trust (MWY)** have been prepping for a scaling up of trade war tensions for a while, assuming the worst as a prudent measure.

'Though it is a risk-off market at the moment, we have generally seen improving cash flows in many of our holdings and we want to avoid selling shares merely because markets may be taking a cautious short-term view,' says Simon Edelsten, manager of Mid-Wynd.

Over the last few weeks the trust has run the rule over its entire portfolio to assess first order effects. That means stocks that could see demand directly affected by recently-announced tariffs.

'About six portfolio investments are directly affected, making up less than 10% of assets, so we are less exposed than equity indices which contain traditional industrial and automotive stocks,' says Edelsten.

European companies such as PerkinElmer, Siemens Healthineers and IPG Photonics all featured, yet were considered to be robust enough to withstand serious hits. Mid-Wynd did top-slice its stake in Agilent, which sells food testing equipment to China.

Second order effects of the current trade dispute were also assessed. This refers to portfolio companies that could see reduced business confidence from a very high level, a slowing Chinese economy (against a background of emerging market weakness and a strong dollar) and, perhaps least discussed, US businesses losing Chinese demand medium-term, possibly to the benefit of Japan.

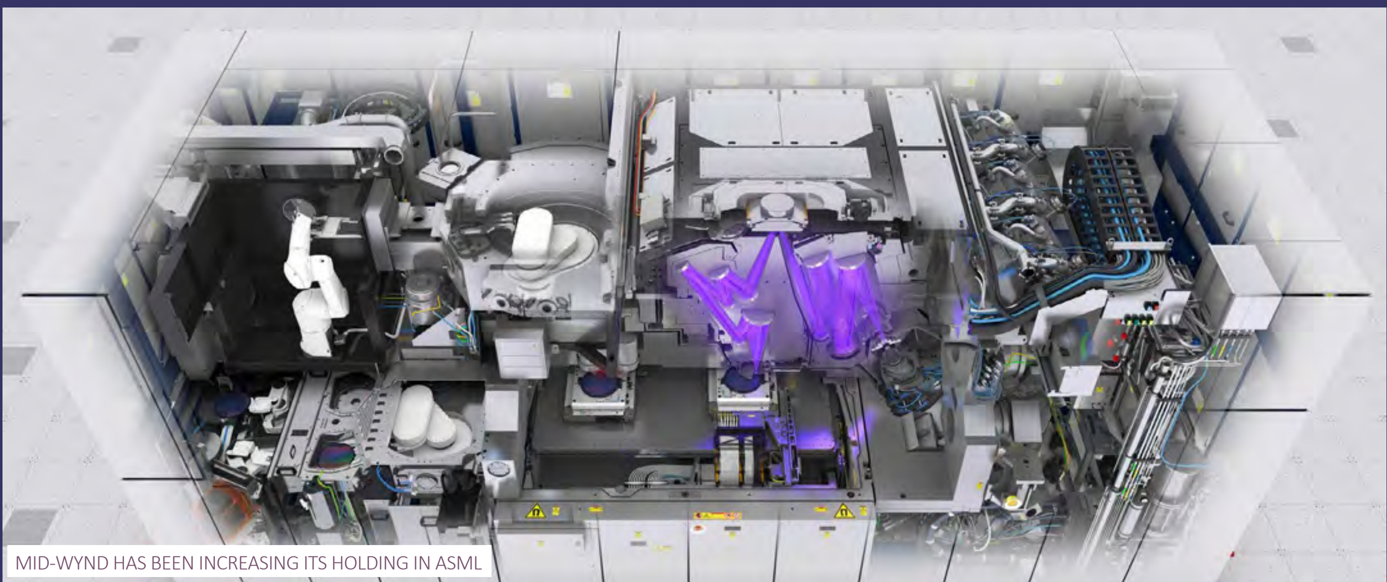
Consumer products giants Procter & Gamble and **Unilever (ULVR)** bore the brunt of the trust's exits.

'The market regards these as defensive stocks, but they could equally be seen as quite expensive equities seeing low growth when emerging market currencies fall,' rationalises Edelsten.

Mid-Wynd remains very keen on microchip companies, including industry giant Intel, which sells globally but may benefit from an 'America First' purchasing policy. The trust also continues to like Cadence and Synopsis, which are seeing a boom in design, and ASML, which makes the semiconductor fabrication plants.

'The ASML share price has been weak during the trade dispute and we have added to our holding as the company may ultimately be a winner,' says Edelsten.

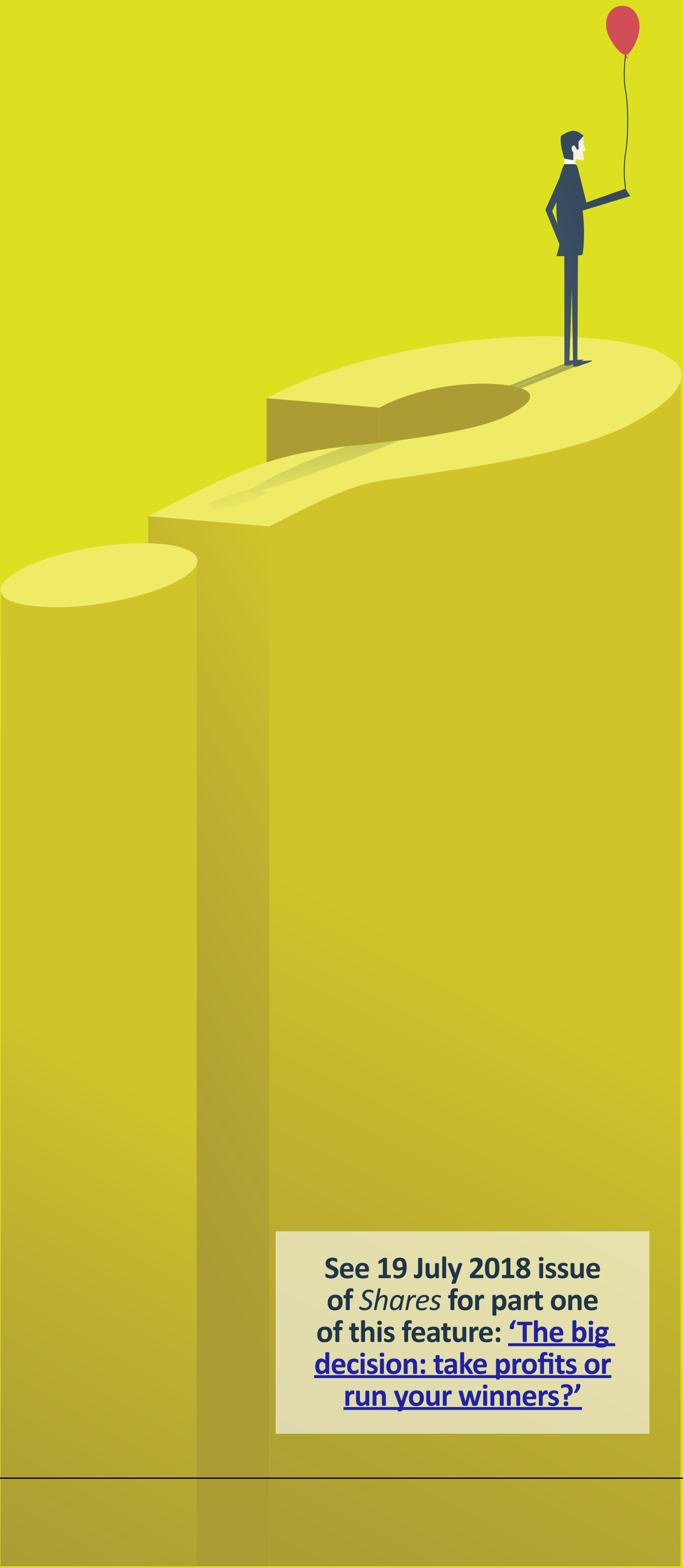
**The ASML share price has been weak during the trade dispute and we have added to our holding as the company may ultimately be a winner**



MID-WYND HAS BEEN INCREASING ITS HOLDING IN ASML

# THE BIG DECISION

## CUT YOUR LOSSES OR HANG ON IN HOPE OF A SHARE PRICE RECOVERY?



See 19 July 2018 issue of *Shares* for part one of this feature: 'The big decision: take profits or run your winners?'

Deciding when to pocket profits after an investment has done well is one thing but knowing when to cut your losses when things go wrong is an even more difficult dilemma.

Share prices and stock markets go up and down all day every day and the reasons for the movements are not always clear. When a share price falls, investors need to make a call: is this a temporary set back or is it time to sell?

Simon Gergel, manager of **Merchants Trust (MRCH)**, comments: 'This is something people don't think about nearly enough, and you can lose a lot of money if you get it wrong.'

### WHAT TO DO

The first step for investors is to determine whether the share price has fallen because it is simply out of favour or because there has been a major event of fundamental change.

Gergel says investors should remind themselves of the reasons they first bought the stock and work out whether these reasons still stand.

If the move is just market noise that's probably not a reason to sell. However, if there has been a material change, the next step is to work out how that changes the outlook for the business and the 'fair value' for its shares.

Investors often have a 'target price' in mind for the shares of companies they invest in – the price they believe is a fair reflection of the value of the business – but they should be constantly re-evaluating what that figure is.

Joe Bauernfreund, manager of **British Empire Trust (BTEM)**, says: 'When a share price falls we have to work out whether it's just got cheaper and we should be buying more or if we have made a mistake.'

### THE LOSS AVERSION MISTAKE

A common mistake that investors make is to do with what psychologists call 'loss aversion': when the value of their investment has fallen they stick with it in the hope that it will recover.

Like a gambler in a casino hoping to win their money back, the belief is that they haven't lost until they have crystallised the loss. But professionals say it's vital to know when it's time to admit defeat and cut your losses.

Gergel once bought shares in telecoms giant **BT (BT.A)** and sold them less than a month later – very unusual for a fund manager.

He says: 'We had a specific reason for investing in the shares but there were accounting issues and a profit warning and the investment case didn't work anymore. We took a 10% to 15% loss on the shares but had we held on it would have been much greater.'

But, he admits, he doesn't always act so quickly: 'We have had other situations that have gone on longer, where we should have realised sooner that it was time to sell.' This can happen when there have been subtle changes in a company over time rather than a single overnight event that hits the shares.

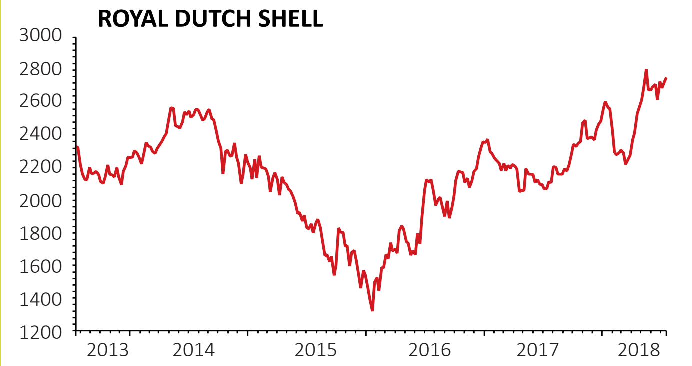
Gergel advises: 'Write down the reasons why you bought a share; that makes it easier to tell if they no longer apply.'

## OTHER REASONS TO SELL

Changes to an industry can also spark a sell decision. Bauerfreund last year sold shares in Canadian company Hudson's Bay, which owns department stores and retail real estate across America.

There wasn't a single event which led to his decision so much as a gradually growing concern about the spiralling state of the sector. He says: 'Retail is getting decimated, profitability is under pressure and it was a situation where the value had fallen and you had to cut your losses.'

There are also times when shares do recover. Gergel added to his investment in **Tate & Lyle (TATE)** earlier this year when he thought the market had overreacted to some short-term issues. After dropping more than 10% overnight the shares have since recovered.




Similarly, he stuck with oil giant **Royal Dutch Shell (RDSB)** two years ago when there was widespread concern it would cut its dividend. With a yield of 8%, Gergel thought even if the dividend was reduced it was still a good option for income; he's made a 100% return on the shares over the past two years.

## WEIGHING UP THE EVIDENCE

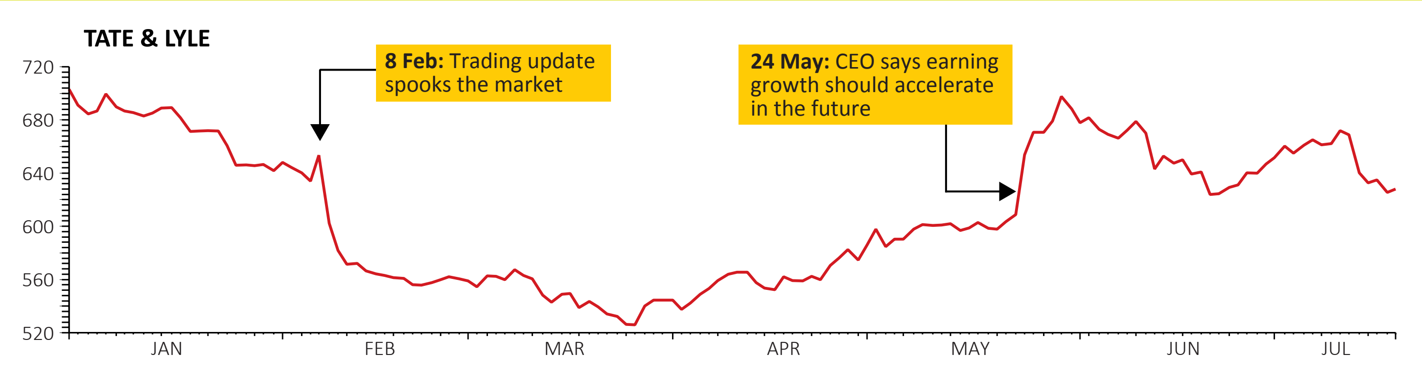
But how do you know when a share will bounce back and when it only has further to fall?

Gergel says: 'Years of experience helps and so does working with colleagues who had different views and challenge you; hearing the other side of an argument is really important.'

Bauernfreund says having the inside track helps. Fund managers are able to meet with the management of the companies they invest in, which bestows them with a much greater insight into whether there are issues.

Having a team of researchers is also vital to him, particularly when investing in small and mid-cap companies, which are not as well covered by analysts as larger firms.

Bauernfreund says: 'We try not to get spooked by what the market does – investors don't always behave rationally – but sometimes the facts change.' (HB)



# Can shares in tobacco companies fight back after a torrid time?

London's listed tobacco titans are determined their high returns won't be vaporised

*By James Crux*

**THE BULL AND BEAR CASE**
Bulls insist the industry is transforming which should enable it to become less controversial and enjoy a higher rate of sustained sales growth.

Bears argue that next generation products are beginning to cannibalise the profitable combustible tobacco business.

Once considered defensive investments and dependable sources of income, tobacco stocks have recently gone through a troublesome period and experienced significant share price declines.

Cigarette companies were long-prized for their strong brands, pricing power, high margins and strong returns on capital, a function of the fact smokers are addicted and willing to stump up premium prices for their brands.

Yet shares in the London-listed **British American Tobacco (BATS)** and **Imperial Brands (IMB)** have de-rated on fears over declining cigarette volumes, the economics of so-called Next Generation Products (NGPs) and the implementation of a nicotine standard across the pond.

Increased health awareness, decreasing social acceptance of smoking and legal and regulatory changes, including the introduction of plain packaging in numerous countries, have steadily reduced volumes.

Also weighing on sentiment is the fact tobacco stocks are considered 'bond proxies' and have sold off amid rising government bond yields.

## HOW ARE CIGARETTE COMPANIES FIGHTING BACK?

In reaction, 'big tobacco' is aggressively investing in NGPs, which bears argue are beginning to cannibalise the profitable combustible tobacco business.

Put simply, the epochal shift from conventional cigarettes to NGPs is driving the biggest changes this sector has seen in living memory.

Yet many well-followed portfolio managers are sticking with the London-listed duo. Neil

Woodford holds Imperial Brands and BAT (British American Tobacco) in his **LF Woodford Income Focus Fund (BD9X6D5)**.

Mark Barnett holds both stocks in **Edinburgh Investment Trust (EDIN)** and BAT is a leading holding in the Michael Clark-managed **Fidelity MoneyBuilder Dividend Fund (B3LNGT9)**.

The pair also features in the Colin Morton-managed **Franklin UK Equity Income (B7DRD63)** and **Franklin UK Rising Dividends (B5MJ560)** funds, while BAT is a long position in the Nick Osborne-steered **BlackRock UK Absolute Alpha (B5ZNQ99)** fund.

We're taking the view that all the bad news is fully priced into the two UK-listed tobacco stocks and that now could be a good time to buy the shares.

## GOING UP IN SMOKE?

Investor sentiment towards the sector is cautious to say the least. 'The market doesn't like the uncertainty the introduction of NGPs has presented and the increased regulatory oversight from the FDA (US Food & Drug Administration),' explains BlackRock's Osborne.

This is on top of illicit trade – a perennial industry headache – and rising regulation in developed markets, all factors behind steady volume declines as population growth remains muted and smoking prevalence continues to fall.

Emerging markets remain promising due to fast population growth, increasing disposable incomes and less-stringent regulatory environments.

Yet even some emerging markets are becoming more aggressive in their tax treatment of cigarettes; recent major tax hikes have been pushed through everywhere from Russia and Brazil to Saudi Arabia, Indonesia and the Philippines.

Last summer, the FDA announced it would move to 'harm reduction' as the basis for regulating the US market and look at the feasibility of reducing nicotine to non-addictive levels in US cigarettes, potentially going far beyond previous attempts to reduce tar and nicotine levels.

## CHANGING FOR THE BETTER?

Bulls insist the industry is at the start of a long transformation, one that should enable it to become less controversial and enjoy a higher rate of sustained sales growth.

The shift to NGPs is sure to be slow, with many hopelessly addicted consumers likely to remain cigarette smokers long into the future.

There is also evidence that public smoking bans and declining affordability are the major causes of volume decline, rather than a dramatic shift in societal attitudes.

## CONSUMPTION TRENDS

Berenberg analyst Jonathan Leinster points out demand for nicotine is actually *rising*, and not declining.

'In our study of 12 major markets, the number of smokers of conventional cigarettes (aka factory manufactured cigarettes or FMC) has declined by about 1% per annum over 2010-18, but the total number of users of vaping, FMC and heated tobacco combined has risen over the same period,' he explains.

'This may be double counting dual-users who both vape and smoke, but even if we assume 50% of vapers are dual-users then the total number of consumers is flat over 2010-18.

'Retail sales of FMC, in US dollar terms, rose 1% per annum over 2010-18 in these markets and rose 2.4% per annum for the combined categories.

'This does not take into account the rising number in volumes of oral tobacco and cigars in the US. Overall, the demand for nicotine is rising and consumers are spending more. The issue for the industry is that governments have become increasingly aggressive at maximising tax revenues and taking a larger share of the gross revenues.'

"The demand for nicotine is rising and consumers are spending more. The issue for the industry is that governments have become increasingly aggressive at maximising tax revenues and taking a larger share of the gross revenues"

Tobacco titans are tackling the threat head on by creating NGPs they can demonstrate are less harmful to consumers.

Their strategy is based on the fact regulators broadly accept 'harm reduction' as a regulatory framework as this implies a greater ability to innovate and market products that are less damaging to health and critically, for a differentiated tax system for them. Bulls believe NGP can and will be profitable, among them the Berenberg analyst.

Leinster believes investor concerns about the future profitability of NGP markets are overdone, the focus on margins misplaced and worries about new entrants ignores the opportunity 'big tobacco' will have against smaller national players and illicit trade.

Big tobacco has already developed products that have gained widespread consumer acceptability in both vaping and heated tobacco, notably Philip Morris International's *iQOS* product, BAT's *Glo* device and JUUL.

## COMPELLING ECONOMICS

Liberum Capital argues that both BAT and Imperial Brands trade at the widest discount to the Consumer Staples sector in over 15 years despite their improving prospects.

'Shares are so depressed that we believe the market is discounting a nicotine standard far earlier than the FDA can reasonably deliver,' thunders Liberum. 'Our base case assumes the US nicotine standard comes in 2023. We see significant upside on conservative assumptions.'

For those unfamiliar with the sector, it is worth re-stating the compelling economics of the major international tobacco manufacturers, which remain intact, for now.

'There are few (if any) low-ticket "must-have" consumable products that one billion people desire on a repeat basis at the same scale and pricing power as tobacco,' says Liberum.

'Cigarettes are cheap to produce at scale and travel well. Tobacco growers and distributors have weak bargaining power.

'Tobacco companies' attractive positions are further entrenched by advertising bans, which makes it difficult for new entrants to steal share. This industry structure and the addictive nature of the product create a highly favourable pricing and margin structure for manufacturers.'

A further strength is that the cigarette industry is highly consolidated. Stripping out China, India and the US, 84% of the global market is spoken for by four players – PMI, BAT, Japan Tobacco and Imperial Brands.

While the consolidated structure of global tobacco makes it more difficult to get regulatory approval for further mergers & acquisitions (M&A), it also means there are fewer price wars among legal competitors, a trait that supports high profit margins.

Bear in mind that cigarettes are a $683bn global market – that is the retail value based on the 5.5trn cigarettes the tobacco industry sold in 2016.

## THE LOWDOWN ON NEXT GENERATION PRODUCTS

The burgeoning band of less harmful NGPs include tobacco heating products (THP), also known as heat-not-burn (HNB), an important category for tobacco giants as they are sold at a higher gross margin than conventional cigarettes.

THPs have done well in Japan, where PMI's IQOS heatstick dominates, while BAT's glo heatstick is in 13 international markets.

NGPs also include electronic cigarettes (e-cigarettes), nicotine delivery systems that use electricity to create a nicotine vapour (they include cigalikes, vape pens, mods and pod-based systems including JUUL and Imperial Brands' *myBlu* and Altria's *CYNC*).

Walk down any high street and (irritatingly if you are a non-smoker), your face will probably encounter a plume of vapour.

BAT believes the vapour category size is £9bn, with approximately 55m consumers currently 'vaping'. This means the market is equivalent to cameras or smart watches and is twice the size of cognac or low/no alcohol beer.

By 2020, the vapour market is expected to be larger than the men's shaving market, with vaping proving especially popular among more health-conscious youths.

During late 2018 and early 2019, BAT is looking to make significant further launches in vaping.

Both Imperial Brands and Japan Tobacco believe that vaping will emerge as the major nicotine format long-term for the bulk of consumers – Imperial's main vaping brand is *Blu*, while Japan Tobacco's is *Logic* – although both are developing heated tobacco products in response to the success of iQOS in Japan and South Korea.

BlackRock's Nick Osborne says the economics of NGPs versus combustibles looks good, 'so the aggregate profit pool isn't changed and existing players take the vast majority of that market – so far, so good for the traditional industry'.

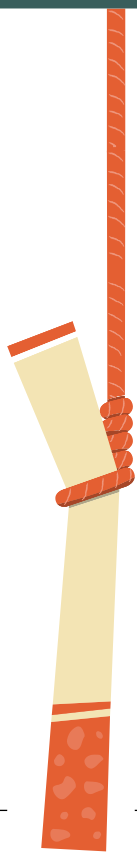
However, he warns there is one area where NGPs appear to be more disruptive and that is vaping, where there is much more fragmentation across the market and in the US particular where the introduction of JUUL's product appears to be taking considerable share.

### LARGE MARKET

More than 1bn people smoke globally. That is roughly 15% of the global population or 20% of the world's adults.

According to Euromonitor, the fastest growing tobacco markets by retail sales are China, Russia, Indonesia, Turkey, Argentina, South Korea, Egypt and Iran.

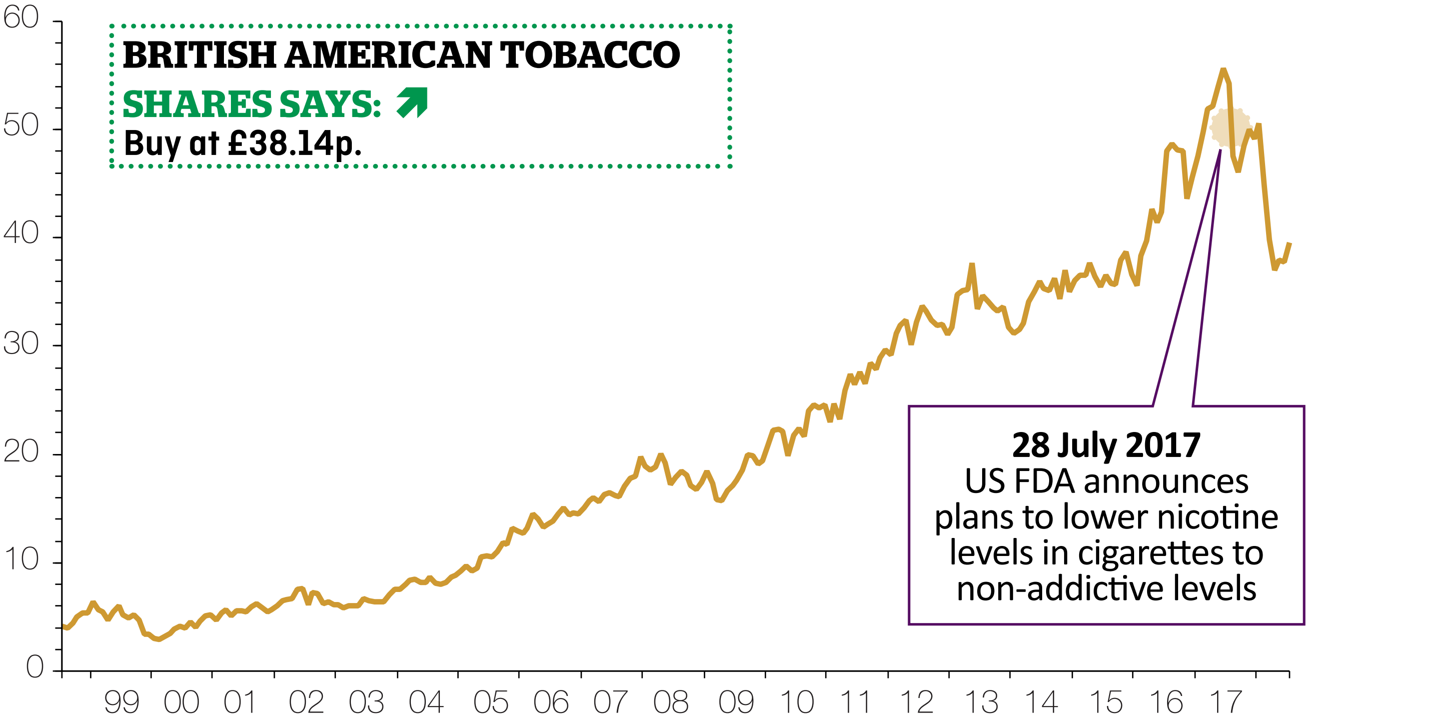
Colin Morton has been adding to both London-listed stocks in his Franklin UK Equity Income and Franklin UK Rising Dividends portfolios. He says that over a long period, they've both produced very good dividend growth and dividend yields and both have very good free cash flow yields and strong market positions.



Whether NGPs present a challenge or an opportunity is 'the million dollar question', chuckles Morton. 'Will they end up being the market leaders in NGPs and will they be able to make the same margins and profitability?' he rhetorically asks.

Morton believes that a lot of the bad news is already in the price and he is willing to take a risk that more likely than not, BAT and Imperial will be the winners no matter what happens.

## BRITISH AMERICAN TOBACCO




BAT has invested heavily in the vaping category, while also doubling-down on the combustible business through its blockbuster takeover of Reynolds American.

A high-quality behemoth armed with strong brands including *Dunhill*, *Kent*, *Lucky Strike*, *Pall Mall*, *Camel* and *Newport*, BAT generates high gross margins north of 85% and is highly diversified with a presence in 200-plus markets and an attractive emerging markets footprint.

However, the £88bn cap faces significant regulatory risk in the US, where the FDA has given advanced notice of proposed rulemaking on setting a nicotine standard, although it is possible a nicotine standard won't be implemented at all.

Following its £41.8bn takeover of Reynolds American, the US has become BAT's biggest and most profitable market.

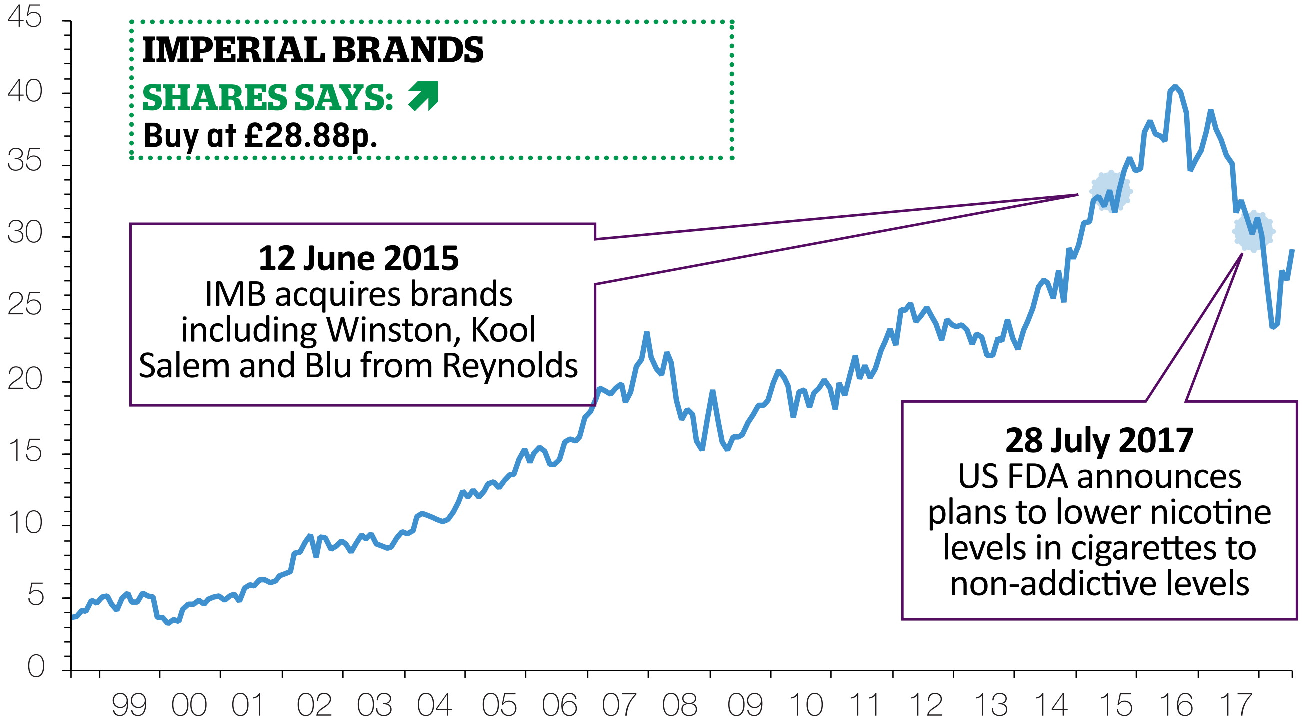
BAT's biggest NGPs opportunity is tobacco heated products (THPs), which generate higher gross margins than the combustible business; the portfolio includes THP product glo, Vype e-cigarettes and the VUSE vapour brand.

BAT has a stated target of NGP sales of £5bn by 2022, 70% of which it sees as being heated tobacco sales, the other 30% vaping-related.

Liberum forecast 2018 pre-tax profit north of £9.55bn, moving to £10.3bn in 2019 and £10.98bn in fiscal 2020.

Based on this year's 295.5p earnings per share estimate and a forecast hike in the dividend to 203.9p (2017: 195.2p), BAT swaps hands for an undemanding 12.9 times forecast earnings and offers a 5.3% prospective dividend yield.

## IMPERIAL BRANDS




Cigarettes, fine cut tobacco and smokeless tobacco manufacturer Imperial Brands is often seen as the sector's growth laggard and rated accordingly, although it is actually gaining share in conventional tobacco.

The smallest of four global tobacco giants, Imperial generates 80% of profits from tobacco in mature markets such as the US, UK, Germany, France, Spain and Australia.

Its growth brands include *Davidoff*, *Gauloises Blondes*, *JPS*, *Winston* and *Lambert & Butler*, while Imperial's specialist brands include *blu*, *Kool*, *Golden Virginia* and *Montecristo*.

Imperial's margins came under pressure in 2017 due to increased brand investment and tough trading in Russia, while 2018 profit will be crimped by the bankruptcy of tobacco wholesaler Palmer & Harvey.

The good news is that under CEO Alison Cooper, Imperial is rationalising its brand portfolio and migrating niche brands to global brands with scale, a strategy designed to deliver better growth and enhanced margins.

The £27.2bn cap is targeting up to £2bn of proceeds from the sale of further non-core brands within the next 12 to 24 months.

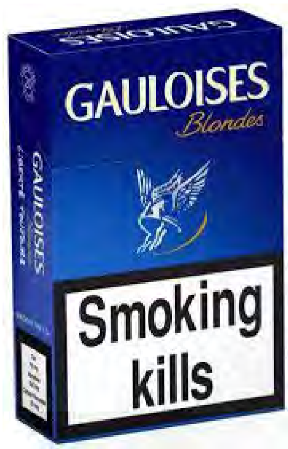
Imperial's NGP portfolio is built around its pioneering *blu* e-vapour brand, although the consumer staple is expected to have a heated tobacco product ready for late 2018 or early 2019.

An income-investor's favourite down the years, Imperial targets 10% dividend growth per year and the half year payout (9 May) was raised by 10% to 56.87p. However, Liberum cautions dividend growth must taper in 2021 'without a meaningful step change in growth'.

Due to its size relative to rivals, Imperial Brands is also a perennial takeover target, although any takeover would be complicated by being a consortium bid; the most likely bidder would be Japan Tobacco, with BAT probably picking up any crumbs from the Japan Tobacco table.

Berenberg forecasts adjusted earnings per share of 267p and 188p dividend for 2018, rising to 279p and 207p respectively in 2019.

On these estimates, the shares trade on a PE of 10.8 with a juicy 6.5% dividend yield.



# Lowland fund manager says portfolio diversification is essential in the current market

Patchy economic conditions warrant some form of protection in case there are portfolio shocks

A leading fund manager has warned of the importance of portfolio diversification in the current economic climate. James Henderson, who co-manages **Lowland Investment Company (LWI)**, says the UK economy is very 'patchy' at present and diversification is needed to get around pockets of weakness.

Having multiple holdings provides a cushion should one or a handful experience difficult times. And such an approach has certainly come to the aid of Henderson who has suffered the collapse of two holdings in Lowland this year: construction group Carillion and drinks distributor Conviviality.

Most investors are likely to experience the odd setback in their career and they should learn from their mistakes. Indeed, Lowland says in its half year results that Conviviality's situation was a 'painful reminder that distribution companies need good financial disciplines and that their quality of earnings can be low'.

Conviviality may have been the biggest detractor to the portfolio in the six months to 31 March 2018, but it is only a minor blot on Lowland's performance. The investment trust's longer-term track record is very good with 13.28% annualised returns over the past decade versus 8.41% from its benchmark, according to Morningstar.

Lowland is happy to include small cap businesses such as Somero Enterprises in its portfolio

## PORTFOLIO STRUCTURE

Lowland typically holds 120 stocks in its portfolio and it seeks to generate capital growth and income. Despite historically having a bias towards small and medium-sized companies, the current portfolio is dominated by larger companies in terms of its biggest holdings.

'Some of the bigger companies are attractive to me in terms of income and straight valuation compared to medium-sized companies. I'm also finding value at the bottom end of the market and Lowland's AIM weighting has gone up,' says Henderson.

Lowland sells itself as having holdings you wouldn't find in many other investment trusts of its kind (i.e. UK equity all-cap), either because they are small or less well known. So why then does it invest in **Royal Dutch Shell (RDSB)**, **HSBC (HSBA)** and **Vodafone (VOD)** which are classic staples of UK equity income funds?

The fund manager says they provide a slight element of ballast but really it is because they are good examples of companies which have previously fallen out of favour with investors over the years.

Marshalls has been in Lowlands portfolio numerous times since 1990

Lowland has a contrarian investment approach and likes to buy stocks when they are unloved.

For example, Shell experienced significant pain when the oil price started to dive four years ago. 'Management had a shock and it was clear the business structure had become too bloated and the cost line out of control. They made changes and it is now a better company.'

## SMALL ALONGSIDE LARGE

Where Lowland is clearly different from its peer group is the blend of large and small businesses. It is quite interesting to see a fund happy to hold a £220m cap business like construction equipment provider **Somero Enterprises (SOM:AIM)** alongside a £35bn business such as media group **RELX (REL)**.

Henderson says the smaller end of the market is where he can really have an edge over other investors. 'You add value by paying attention to things other people aren't following, such as stocks where there are very few analysts covering it. You are more likely to notice if it is underpriced.'

One of his current favourites is **Randall & Quilter (RQIH:AIM)** which manages run-off insurance assets. He also likes drug company **4D Pharma (DDDD:AIM)** which he calls a well-funded company with drugs being tested and which has an attractive tie-up with pharma giant Merck.

'Sometimes stocks get overhyped and people get bored of them so the share price drifts. That's happened with 4D Pharma yet real progress is being made with its portfolio.'

## TRADING IN AND OUT

The investment trust typically holds stocks for five to seven years and isn't afraid to trade in and out of stocks depending on variations in valuation and movements with the business cycle.

For example, paving stone specialist **Marshalls (MSLH)** has been in its portfolio numerous times since the 1990s. Firms in its sector do well when the economy is booming, the housing market is strong, and the public sector is spending money. But building materials stocks suddenly go out of favour when the economy turns, interest rates go up and projects are put on hold. Eventually the cycle will start again.

'We buy when these companies are out of favour. Marshalls is a wonderful company and when people become more confident about its prospects, its rating goes up. You then need to start reducing your holding before the cycle turns.'

Henderson says he is always moving too early, albeit he says his style requires selling into upswings so as to recycle cash into more out-of-favour shares. Last year he sold out of chemicals group **Scapa (SCPA)** when the rating became high. He's been top slicing **Herald Investment Trust (HRI)** which he calls a 'good holding' but where the rating has shot up amid tech stocks trading on higher multiples.

## WAITING FOR THE RIGHT ENTRY POINT

Knowing when to pounce on unloved shares can be very tricky as there is a risk of 'catching a falling knife', namely buying when a company's shares are in freefall and still have further to decline in value.

The fund manager says UK domestic earners are currently having a difficult time 'which is good for me'. However, he says it is still too early in the cycle to start buying depressed UK retail stocks.

'Wages are not keeping pace with inflation and there are clear Brexit uncertainties. That leads to lower valuations. But there is long-term structural growth for online retailers to consider. I'm looking at **Dunelm (DNLM)** at the moment but I won't do anything about it yet. I will wait.'

This kind of patience and discipline is to be applauded as many investors get caught up in the rush when they find an idea, acting first and thinking later. (DC)

# Achieving true dividend diversification with funds

Investment experts revive the debate about some income funds being too reliant on just a handful of sectors

Neptune Income's portfolio is made up of stocks including Apple

Several investment experts have recently resurrected the debate about how many UK income funds are reliant on just a small selection of stocks to deliver their dividends.

Among them is Robin Geffen, the founder and chief executive of Neptune Investment Management and manager of **Neptune Income (B8JCR45)**, who says just 20 stocks account for 57% of the UK Equity Income fund sector's total dividends.

He reckons many of these stocks could be forced to scale back their payouts when rising interest rates put pressure on their earnings.

This undermines a key advantage of investing for income through funds – namely that through buying a fund with multiple holdings you reduce the risk of your income taking a big knock if one or two companies cut or cancel their dividends.

## TAKING A BROADER VIEW

Not all income funds are so heavily exposed to a handful of big dividend payers.

Some will scour the market to identify lesser-known opportunities. Investing in these funds may provide more effective diversification for investors.

Steered by noted small cap enthusiast Gervais Williams and his colleague Martin Turner, **LF Miton UK Multi Cap Income (B41NHD7)** is invested in the likes of FTSE 100 oil stocks **Royal Dutch Shell (RDSB)** and **BP (BP.)** but a large portfolio upwards of

| SANLAM'S WHITE LIST: SUPERIOR INCOME FUNDS |
|---|
| LF Miton UK Multi Cap Income |
| AXA Framlington Monthly Income |
| Marlborough Multi Cap Income |
| Slater Income |
| Royal London UK Equity Income |
| SLI UK Equity Income Unconstrained |
| MI Chelverton UK Equity Income |
| Majedie UK Income |
| Premier Monthly Oncome |
| RBS Equity Income |
| JOHCM UK Equity Income |
| Premier Income |
| Man GLG UK Income |
| Lazard Multicap UK Income |

## WATCH SAINTS' FUND MANAGER DISCUSS HOW HE GENERATES INCOME


120 holdings means it is not too reliant on these dividends.

It has a track record of success, placing at the summit of wealth manager Sanlam's White List of top-ranking equity income funds for the last three years.

In order to come up with this list Sanlam examines the previous five individual calendar years of performance, five-year levels of volatility and the total dividend income distributed over the five-year period.

Each of these metrics is weighted using a consistent formula, ranked individually, and then used to identify the funds with the best combination of performance, volatility and income paid.

Another White List constituent which offers genuinely diversified income is **SLI UK Equity Income Unconstrained (B1LBSV5)**. Although it has a smaller number of holdings at 61, the fund has a significant weighting to mid-cap and small-cap stocks which makes it less reliant on some of the big FTSE 100 dividend payers.

Nearly 60% of the fund is invested in the FTSE 250 and FTSE Small Cap indices.

### THE INVESTMENT TRUST ROUTE

You don't have to restrict your horizons to traditional open-ended funds. Investment trusts are another option and their structure helps reduce the risk of dividend disappointment (see 'How different types of fund pay out income').

Run by Baillie Gifford's James Dow and Toby Ross, the **Scottish American Investment Company (SCAM)** – also known as SAINTS – yields 3.1% and has a strong income track record underpinned by investments in international firms.

In a similar fashion, **Henderson International Income (HINT)** generates its income stream from holdings in many different geographic regions and sectors. It yields 3.2%. (TS)

### HOW DIFFERENT TYPES OF FUND PAY OUT INCOME

THE MOST POPULAR types of funds are unit trusts and open-ended investment companies (OEICs).

These receive the income on the underlying assets, such as dividends, bond interest or rent, and then distribute it on a regular basis.

Some funds pay out once or twice a year, others do it quarterly or monthly.

Another option is an investment trust. Unlike their open-ended counterparts they are not required to pay out all of the income each year to investors.

This allows them to hold back some of the money so that they can smooth future dividend payments to help produce a steadily increasing stream of income, or maintain dividends in tougher times.

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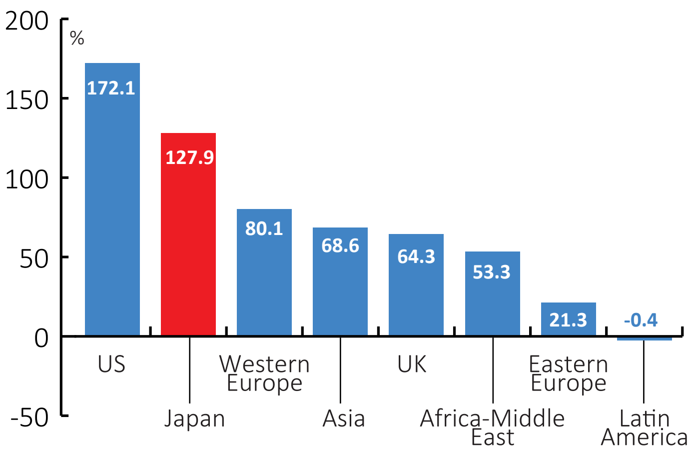
# The case for and against Japan

Japanese shares have outperformed since Abe became PM in 2012 but can that continue?

Japan's Nikkei 225 index has quietly been one of the best performing major markets in recent years. It is the second-best performer out of eight available major equity market options (in sterling, total-return terms) since Shinzō Abe became prime minister for a second time in December 2012 and immediately launched his 'Three Arrows' programme.

**JAPAN HAS PERFORMED STRONGLY UNDER 'ABENOMICS'**




Source: Thomson Reuters Datastream, since Shinzo Abe became Prime Minister on 26 December 2012

The combination of fiscal stimulus, accommodative monetary policy (with the help of the Bank of Japan) and social and corporate reform does look to have boosted equity returns from the Tokyo market. The question that investors must address now is whether this can continue or not?

## THE CASE AGAINST JAPAN

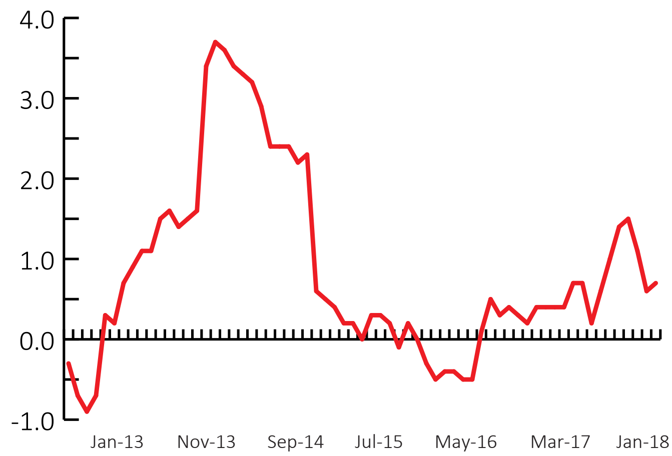
The 'Three Arrows' may be hitting the target, but sceptics will argue Japan is still far from a sound asset allocation option, even nearly 29 years after the bursting of a debt-fuelled equity and property market bubble that peaked in 1989.

**1 Debt.** Hampered by poor demographics, in the form of an ageing population, and the legacy of previous, failed attempts to spend its way out of trouble and into growth, Japan is saddled with huge debts. Government debt is 232% of GDP according to the Bank of Japan (BoJ).

That is the highest figure in the world and one that leaves the Abe administration with less ammunition than it would like. An increase in consumption tax from 8% to 10% is planned for October 2019, to raise some cash, but this has already been delayed for three years and with good reason, since 2014's increase from 5% to 8% pushed the country into recession.

**2 Growth and inflation.** Both remain tepid. The economy shrank quarter-on-quarter in Q1 of this year, the first decline in nine quarters. Although some have blamed a harsh winter for that dip, the weather cannot be blamed for the Bank of Japan's clear failure to drive inflation toward its 2% target. Governor Kuroda has even stopped giving a timescale for its inflation goal to be reached in what could be a tacit admission of failure.

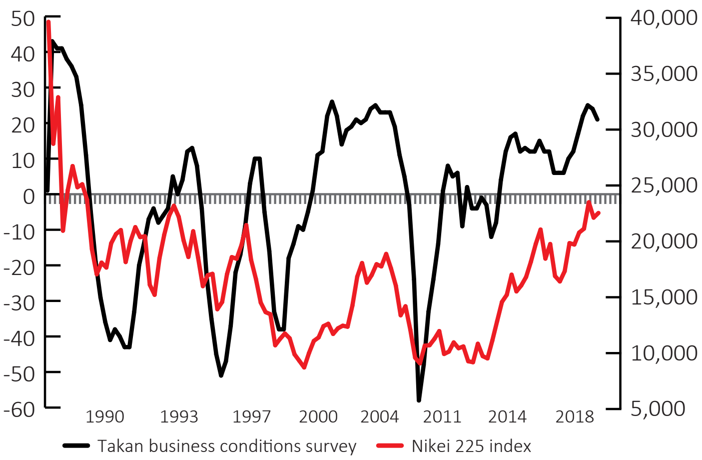
**INFLATION HAS FAILED TO CATCH FIRE DESPITE 'ABENOMICS...'**




Source: Thomson Reuters Datastream

In addition, corporate confidence, as measured by the Tankan survey, has begun to dip again. This matters as the Nikkei 225 stock index does seem to draw inspiration from the quarterly Tankan.

## INVESTORS NEED TO WATCH THE TANKAN CORPORATE CONFIDENCE SURVEY




Source: Bank of Japan, Thomson Reuters Datastream

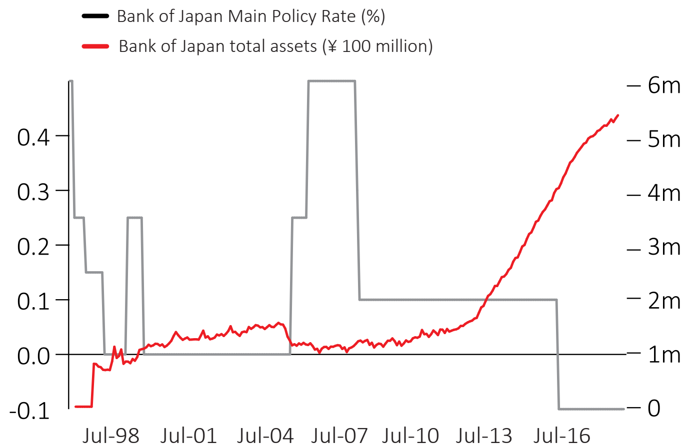
**3** **Politics.** Financial markets still seem to be in thrall to Prime Minister Abe, but Japanese voters seem less enamoured. A series of scandals have seen the Cabinet's approval rating drop to the lowest level since the Abe administration began in 2012, according to data from Japan Macro Advisers.

Abe won a third straight general election in December 2017 and he seems primed for a run toward the 2021 ballot, but nothing can be taken for granted given the generally short lifespan afforded to leaders of the Liberal Democratic Party. Were Abe to unexpectedly fall from office markets could take fright, at least temporarily.

## THE CASE FOR JAPAN

• **The Bank of Japan.** The Bank of Japan is holding interest rates at -0.1% and showing no sign of either raising them or backing away from its ¥80tr a year qualitative and quantitative easing programme, which is it using to buy government bonds, to force down their yield, and purchase exchange-traded funds (ETFs) that track Japanese stocks. Low returns on cash and bonds could force investors toward equities, as has happened in the UK, US and Europe, especially as they might get to ride a tidal wave of BoJ cash there, too.

## THE BANK OF JAPAN CONTINUES TO RUN AN ULTRA-LOOSE MONETARY POLICY




Source: Thomson Reuters Datastream

• **Corporate reform.** Encouraged by the creation of the JPX-Nikkei 400 index, which includes firms on the base of profits and governance not size, Japanese corporates are raising their game. Dividends and share buybacks are on the up while research from Japan Macro Advisers shows that return on equity (ROE) amongst Japanese

corporates is rising as profit margins expand. ROE now exceeds the 8% goal laid out by a 2014 Government paper.

• **Valuation.** Japan's stock market is not trading at or very near to its all-time highs, unlike say the UK or US. In fact, at around the 22,800 mark the Nikkei 225 index trades more than 40% *below* the peak it reached in December 1989.

As a result, Japan looks relatively cheap compared to other major markets, on an earnings basis, especially as profits are nowhere near past peaks, in contrast to the US and UK. Japan looks cheaper still on 1.3 times book (or net asset) value, according to research from M&G, especially as a lot of the assets are simply cash.

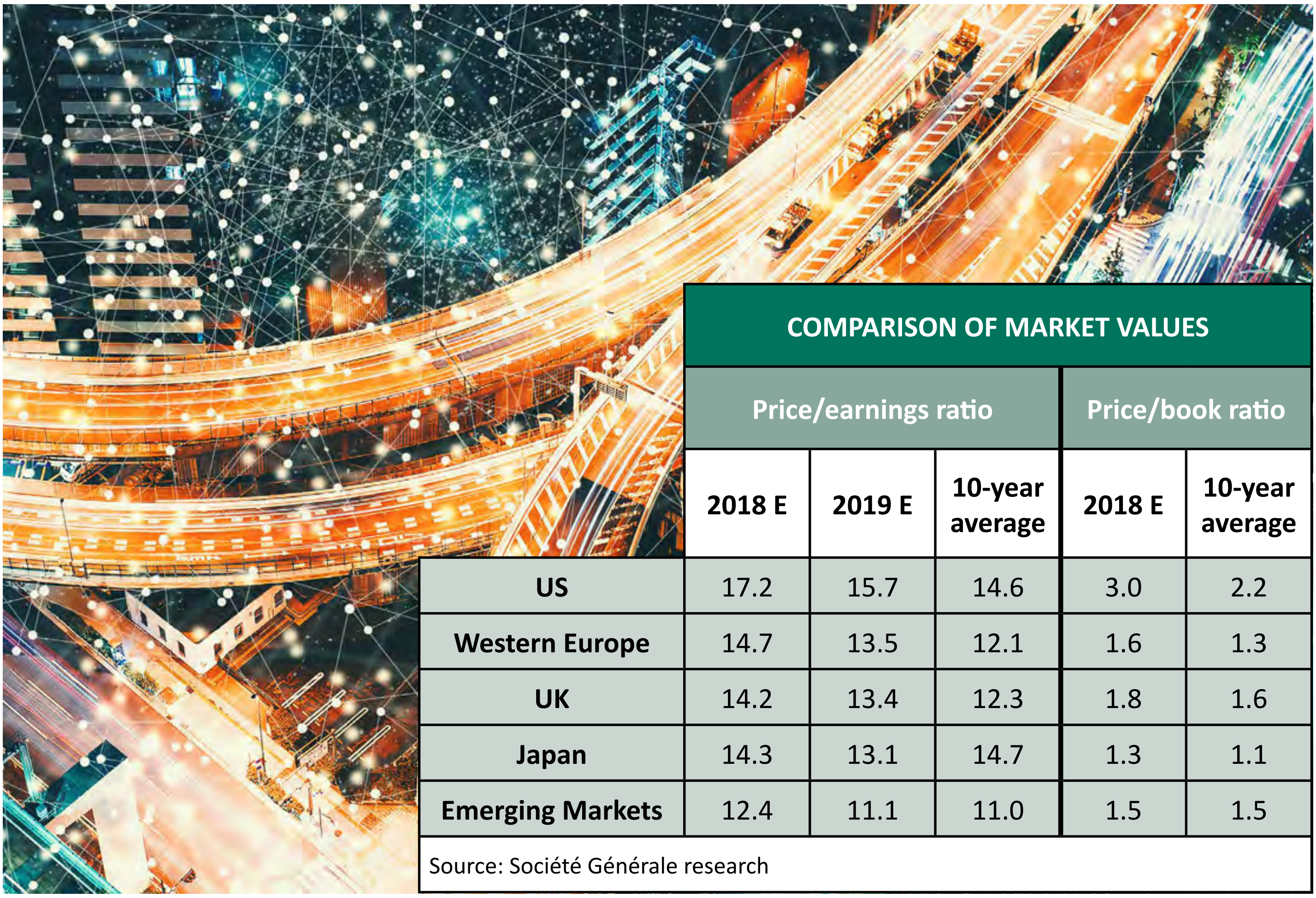
**JAPAN'S NIKKEI 225 STILL TRADES WAY BELOW ITS 1989 PEAK**


Source: Thomson Reuters Datastream

## TEST CASE

After more than two decades of interest rates below 1%, multiple fiscal stimulus programmes and over a dozen rounds of QE since the early 1990s, Japan is the model that no western central banker wishes to emulate. As such, the Abe and Kuroda regime remains a key test case, as the European Central Bank and Bank of England continue to run ultra-loose monetary policy and the US Federal Reserve continues to tighten at a very steady pace.

**Russ Mould, investment director, AJ Bell**



**COMPARISON OF MARKET VALUES**

| | Price/earnings ratio | | | Price/book ratio | |
|---|---|---|---|---|---|
| | 2018 E | 2019 E | 10-year average | 2018 E | 10-year average |
| US | 17.2 | 15.7 | 14.6 | 3.0 | 2.2 |
| Western Europe | 14.7 | 13.5 | 12.1 | 1.6 | 1.3 |
| UK | 14.2 | 13.4 | 12.3 | 1.8 | 1.6 |
| Japan | 14.3 | 13.1 | 14.7 | 1.3 | 1.1 |
| Emerging Markets | 12.4 | 11.1 | 11.0 | 1.5 | 1.5 |

Source: Société Générale research

# How you can use gifting rules to give your child or grandchild a £1m pension

We explain how to get the most out of inheritance tax allowance

Parents or grandparents can save on their inheritance tax bill and put away more than £1m in their children's or grandchildren's pensions by making use of lucrative gifting allowances.

When people die their estate will have to pay 40% inheritance tax on anything above £325,000. In addition to this, they can make use of the new residence nil rate band.

Generally, any gifts made by individuals from their savings are subject to the seven-year rule for inheritance tax purposes. This means that if they die within seven years of making the gift inheritance tax will be due, on a sliding scale depending on how long ago the gift was made.

However, each year every individual can give away some of their money without this tax rule applying.

### GIFTING RULES

Each person can give away up to £3,000 each year, moving it out of their estate for inheritance tax purposes.

What's more, if you didn't use the allowance the previous year you can use double the allowance in the current tax year. There are other exempted gifts too, including for a child or grandchild's wedding, but we'll leave them aside for now.

**GROWTH OF COUPLE'S ANNUAL GIFTING ALLOWANCE IN A PENSION**

| Year | Interest | Balance |
|---|---|---|
| 1 | £248 | £7,748 |
| 2 | £974 | £15,974 |
| 3 | £2,208 | £24,708 |
| 4 | £3,980 | £33,980 |
| 5 | £6,324 | £43,824 |
| 6 | £9,276 | £54,276 |
| 7 | £12,871 | £65,371 |
| 8 | £17,152 | £77,152 |
| 9 | £22,159 | £89,659 |
| 10 | £27,937 | £102,937 |

Notes: Based on annual contribution of £6,000, plus tax relief, taking total to £7,500

If parents or grandparents used their annual gifting allowance to contribute to their child or grandchild's pension, they can make use of the double whammy of Government tax relief and compound interest to hand their offspring a healthy retirement pot. It is important they have this money to spare each year and do not need it to supplement their income.

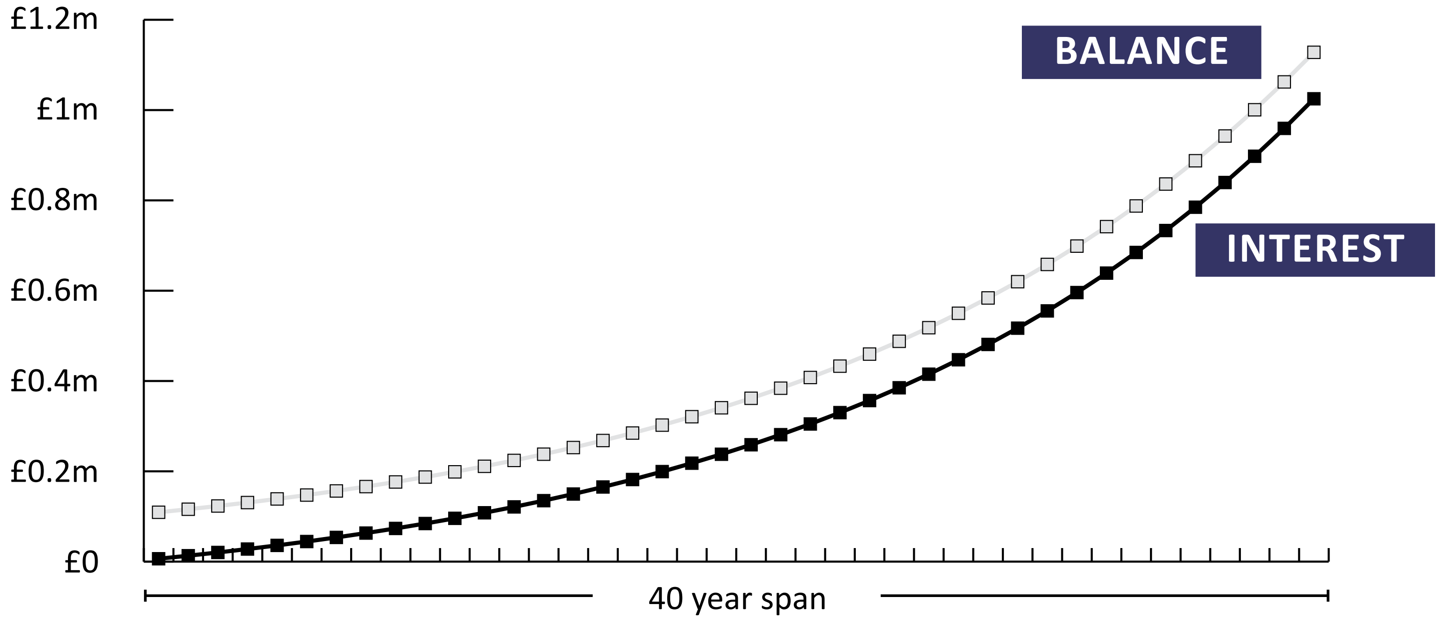
If each individual gifts £3,000 into a pension in their grandchildren's names, for example, this is increased to £3,750 with tax relief. This means between a couple each year £7,500 can be put into a pension (see below for the limits on contributions).

### AN EXAMPLE OF HOW MUCH A PENSION COULD BE WORTH

Let's assume a couple want to put away money for their grandchildren. If the couple contributed the full £6,000 each year between them, every year for 10 years, collectively their grandchildren's pensions would be worth almost £103,000 after tax relief, assuming annual growth of 6%.

However, the nature of

## GROWTH OF THE £103,000 PENSION POT OVER 40 YEARS




pensions is that they are invested over long periods of time, and this means they benefit from the magic of compounding – where you effectively get returns on your returns.

This is particularly the case in this example, as the grandchildren are likely to be young and have a long time until retirement, when they can claim their pension.

This means if the aforementioned £103,000 pot was left for 40 years, with no further contributions, it would be worth a whopping £1.13m, assuming that same 6% annual growth. Even if the money was only left for 30 years, it would be worth £620,000.

What's more, £60,000 of the couple's money would have been moved out of their estate, and so no inheritance tax would be paid on it – saving a potential £24,000 tax bill.

### WHAT ARE THE LIMITS?

You don't have to be an adult to have a pension. Children can have a pension opened in their name, and they get tax relief at a 20% rate. However, the rules are the same as an adult: you will only get tax relief on pension contributions of up to 100% of what you earn in any tax year or on £3,600 – whichever is greater.

> **If the £103,000 pot was left for 40 years, with no further contributions, it would be worth a whopping £1.13m, assuming the same 6% annual growth**

As most children will earn nothing, they can make use of the basic limit and up to £2,880 can be put into their pension in the current tax year. This will be increased to £3,600 after tax relief – taking it to the maximum limit.

This means if you're going to use the gifting plan above for inheritance tax purposes, and make use of the full £3,000 a year allowance, you would need to contribute to more than one child's pension, or contribute to a child and an adult's pension.

If you are contributing into someone's pension who is earning money, whether they are a child or adult, you will only get tax relief on pension contributions of up to 100% of what they earn.

For example, if the person in question earns £5,000 in a tax year and you want to contribute £6,000 to their pension, they will only get tax relief on the first £5,000.

If the adult is a non-taxpayer, because they don't work, for example because they are in education or a stay-at-home parent, then they get the same £2,880 allowance as we talked about for a child, which is topped up to £3,600 after 20% tax relief.

**Laura Suter, personal finance analyst, AJ Bell**

# Lessons from the FCA's platforms market study

It is important to check fees and the suitability of your platform

The Financial Conduct Authority (FCA), the regulator of the financial services industry, has been busy recently kicking the tyres of the pensions and investment markets to ensure they are delivering value for money for investors.

First, its asset management market study assessed the value for money investors are getting from fund managers. The regulator then turned its attention to pension companies through the retirement outcomes review.

In its latest 110-page tome, the FCA focuses on platforms – online offerings like AJ Bell Youinvest, The Share Centre and Interactive Investor that are designed to help people save and invest.

Here are a couple of the key lessons DIY investors can learn from the regulator's latest paper.


## SHOPPING AROUND

The fees platforms charge vary significantly. Indeed, according to the FCA charges on a pot of £5,000 investing in a Stocks and Shares ISA can be as low as 0.2% or as high as 2.4%. Over five years that could equate to an extra £650 in returns (assuming a 5% annual growth rate) at the lowest end of the fee range.

Furthermore, the platform that represents the best value for you might depend on how much you have to invest. Some charge a percentage of your fund, some charge a flat fee, and some charge a combination of the two.

Some also wrap things like trading into a single fee, while others charge you each time you buy and sell stocks and shares. Platforms also have different levels of service and functionality which might be important to you – although in the FCA's study most consumers cited price as the key factor affecting their choice.

It's therefore worth your while shopping around the market and comparing service and charges to find the right platform for you.

Firms such as the Lang Cat, a platform consultant, have useful 'heat maps' to help you compare platform prices based on the size of your portfolio.

## ORPHAN CLIENTS

According to the FCA, there are just over 400,000 so-called 'orphan' clients in the UK. In simple terms, these are people who have previously had an adviser – and so are on a specialist adviser platform – but who no longer receive advice. This might be because they have parted company with their adviser, or because the adviser has retired or gone out of business.

If this is you, it's worth considering either appointing a new adviser or moving your money onto a more appropriate DIY platform.

Adviser platforms tend to be designed to suit the needs of advised clients and so are unlikely to be appropriate to a direct customer.

Some adviser platforms also levy extra charges for orphan clients to cover extra administration costs.

**Tom Selby, senior analyst, AJ Bell**

# Venture Life seeks a step change in growth with major fundraise and strategic acquisition

The healthcare company is also aiming for at least 10% annual organic sales growth

If you have ever shopped in Boots or Superdrug, you may be familiar with some of international healthcare group **Venture Life's (VLG:AIM)** products.

One of its biggest brands is *UltraDEX*, an oral healthcare product range that was introduced through the acquisition of Periproducts in 2016.

Venture Life develops, manufactures and commercialises self-care products for companies, including healthcare products acquirer **Alliance Pharma (APH:AIM)**.

The business was founded in 2010 by Jerry Randall and Sharon Collins, who previously worked together at **Sinclair Pharma (SPH:AIM)**. After merging with Italian contract manufacturer Biokosmes, the company floated on the stock market in 2014 at 109p.

The shares currently trade 59% lower at 45p despite robust revenue growth over the last few years and a profit breakthrough in 2017.

The stock market performance has been disappointing yet the stock is arguably at a turning point, both financially and strategically.

A major fundraise has now been proposed which should strengthen the balance sheet and help pay for the acquisition of Dentyl which comes with mouthwash and breath freshener products.


Inside Venture Life's manufacturing facility

## TAPPING INTO SELF-CARE TRENDS

One of the biggest catalysts for Venture Life is an ageing population, which is expected to increase demand for self-care products as people look to take better care of themselves in old age.

Northland Capital analyst Vadim Alexandre argues the burden of care is shifting to individuals due to pressure on global healthcare systems amid the global obesity epidemic.

In Europe, the self-care market is worth £20bn according to data from the Association of the European Self-Medication Industry.

Venture Life wants to grow its presence in Europe, China and the US. In a bid to tap into high demand, it manufactures food supplements, including *NeuroAge* to improve brain function and the *Benecol* brand to lower cholesterol.

The company also develops medical devices focusing on women's intimate health through the *Vonalei* brand and cosmetics such as Chinese skin care range *Lubatti*.

## STRONG REPEAT REVENUES

Venture Life benefits from loyal customers as approximately 90% of its sales are from repeat orders.

Its biggest client, Alliance Pharma, accounts for 24% of sales and recently renewed a contract for the manufacture of oral care and dermatological products until 2025.

The contract covers the manufacturing of Alliance's eczema treatment *Atopiclair* and mouth ulcer medication *Aloclair*, and offers sales visibility from a key customer.

Other customers include Japanese conglomerate Sunstar, Spanish pharma company Almirall and Swiss pharma group Helsinn, representing under 10% of sales each.

*UltraDEX* products, including mouthwash and toothpaste, are priced a premium compared to well-known competitor brands such as *Listerine* and *Colgate*.

Venture Life manufacturing director Gianluca Braguti says *UltraDEX* products should not be compared to these other popular brands as they are medicated.

## AMBITIOUS GROWTH ASPIRATIONS

Chief executive officer Jerry Randall says the company is aiming for between 10% and 20% annual organic sales growth, which could be supplemented through acquisitions.

Indeed, Venture Life has proposed the acquisitions of mouthwash product *Dentyl* and breath-freshening capsules *BB Mints* for £4.2m, which are expected to be earnings enhancing in the first financial year.

An oversubscribed fundraising of £18.7m – if approved by shareholders – will be used to fund the acquisitions, explore more M&A and repay convertible bonds and loan notes. The latter will result in its interest expense falling by £0.3m a year.

Future acquisition targets must have a well-known brand in a niche market and be innovative and profitable, with products preferably specialising in oral healthcare.


To achieve higher organic growth, expanded global distribution is being targeted via existing and new businesses, as well as more distribution deals for *UltraDEX*.

## PARTNERSHIP TARGET

*UltraDEX* is currently partnered in 14 markets. Venture Life is on track for 30 partnerships by 2020 and new undisclosed products are in the pipeline.

Panmure Gordon analyst Mike Mitchell says the pipeline offers a runway of new product launches in 2018 and 2019 without risks associated with clinical development campaigns for pharma products.

## POTENTIAL EXPANSION IN THE WORKS

At the heart of Venture Life's operations is its manufacturing facility in Italy where 650 products and 21m units were made last year.

The facility could be expanded to meet demand although it currently has 50% spare capacity.

Braguti believes customers are drawn to the company for manufacturing thanks to its flexible mixing capacity. Venture Life can develop products with capacity of at least 8 litres to up to 8,000 litres.

As a precautionary measure should there be any potential delays or production issues, a recovery plan is in place with a backup of approximately 1,200 formulations.

All goods are circulated via partnerships or distributors with retailers such as Amazon, **Tesco (TSCO)** and **Ocado (OCDO)** receiving discounts for selling Venture Life's products.

If tougher import tariffs on goods from the EU into the UK are enforced post-Brexit, the *UltraDEX* range would be affected, representing 20% of sales.

In this scenario, the company would move manufacturing of *UltraDEX* to a second manufacturer in the UK. (LMJ)

*DISCLAIMER: The author attended a trip to Venture Life's manufacturing facility in Italy which was paid for by the company*

# Share buybacks come under scrutiny from politicians and Government

A report is being compiled into whether companies are using buybacks to artificially inflate executive pay

Share buybacks have been in the news again after politician Vince Cable referred to them as 'a scandalous trick' used by listed companies to artificially inflate directors' pay. A share buyback is where a company buys back its own shares from shareholders.

Certainly we have seen a surge in popularity for buybacks in recent years. A Goldman Sachs report revealed UK companies spent £15bn buying back their own shares in the 12 months to 31 January 2018.

There are many reasons why a company might want to do this. Often it is a way of returning surplus cash to shareholders. There is however growing concern that some companies may be using buybacks to increase their earnings per share (EPS) in order to deliver enhanced executive remuneration packages.

The problem being that any increase in EPS is largely artificial as it is driven by the reduced number of shares in issue rather than any underlying increase in profitability.

This concern led to the Government announcing earlier this year that it is commissioning a report into buybacks and whether companies are using them to artificially inflate executive pay. The report is due to be published later this year.

For those companies planning to make share buybacks (whether through market purchases or off-market), there are a number of legal and regulatory factors to consider.

The procedure for carrying out a share buyback is set out in Part 18 of the Companies Act 2006. Failure to comply with these provisions will result in the purchase being void and an offence being committed by the company and any officer in default.

Companies require shareholder approval before they can carry out a buyback. Listed companies will typically seek shareholder approval at their AGMs to carry out a buyback of up to 10% of their issued share capital.

Listed companies must also comply with the relevant provisions of the Listing Rules, the EU Market Abuse Regulation (MAR) and the Disclosure and Transparency Rules relating to share buybacks.

In addition, companies seeking shareholder approval for buybacks should pay heed to investor guidelines including the 'Share Capital Management Guidelines' published by the Investment Association.

These guidelines make clear that dividends remain the preferred method for returning surplus funds to shareholders and if a company does want to purchase its own shares, it should only do so if it is in the best interests of shareholders and results in an increase in EPS.

It will be interesting to see whether, following publication of the Government's report into share buybacks later this year, further regulatory restrictions are imposed on companies wishing to purchase their own shares.

**Jessica Adam,**
**partner at Macfarlanes**

# INDEX

**KEY**

- Main Market
- AIM
- Fund
- Investment Trust



## KEY ANNOUNCEMENTS
## OVER THE NEXT SEVEN DAYS

### HALF YEAR RESULTS:

**27 Jul:** Pearson, Reckitt Benckiser, Rightmove. **31 Jul:** BP, Centrica, Greggs, IMI, Just Eat, Provident Financial, Rentokil Initial, Shire, Standard Chartered, Travis Perkins, Taylor Wimpey, Weir. **1 Aug:** BAE Systems, Capita, Direct Line, Dignity, Man, Lloyds Banking, Rio Tinto, Smurfit Kappa, St James's Place. **2 Aug:** Barclays, ConvaTec, Merlin Entertainments, Rolls-Royce, RSA Insurance, Serco

### TRADING UPDATES:

**31 Jul:** Thomas Cook. **1 Aug:** Next. **2 Aug:** Sage

## 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.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