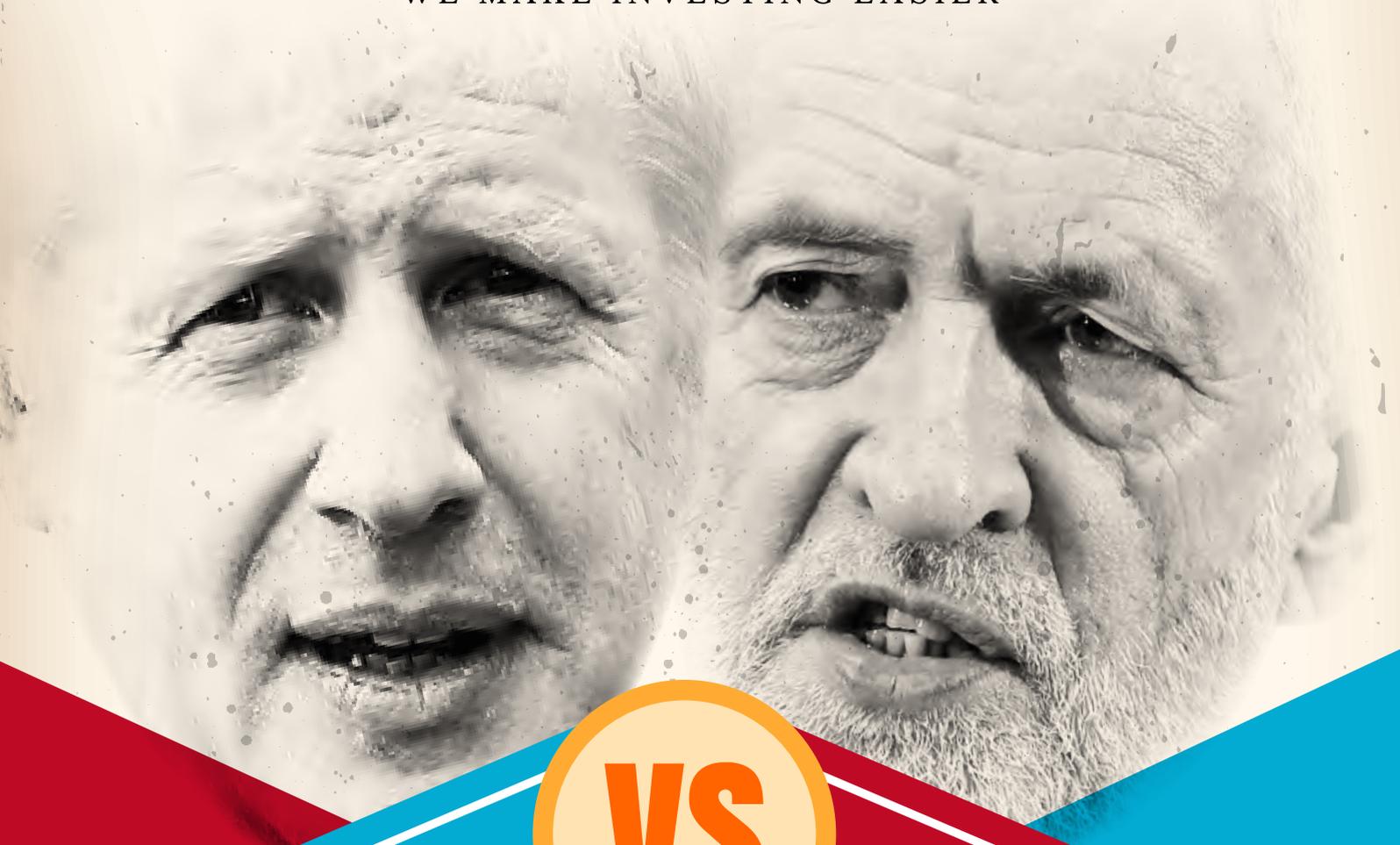


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DEADLINE LOOMS  
TO TAKE PART IN  
**WHITBREAD'S £2BN**  
TENDER OFFER

GRAB **POLAR**  
**CAPITAL TECH**  
**TRUST** WHILE IT  
IS GOING CHEAP

**INHERITANCE**  
**TAX SYSTEM**  
COULD SEE  
MAJOR OVERHAUL

# Inheritance tax review questions AIM IHT perk

Withdrawing the tax benefit would send shock waves across the junior market

**M**any people invest in certain types of AIM stocks for their inheritance tax (IHT) benefits, however an adviser to the UK Government has questioned whether the tax perk is still necessary.

Withdrawing the IHT benefit could prompt many investors, including a large number of wealth managers, to sell these AIM stocks. Should you worry or has the risk been overplayed?

At the moment, your estate won't have to pay the 40% IHT charge upon your death for any investments in AIM stocks that qualify for business property relief (BPR), subject to certain conditions.

This tax perk has led to many investors, including several AIM IHT portfolio services, owning the same group of stocks and bidding up their price in the interim. Popular names include tonic water specialist **Fevertree Drinks (FEVR:AIM)** and flooring manufacturer **James Halstead (JHD:AIM)**.

BPR legislation was introduced for family firms passed down through generations so that inheritance tax bills wouldn't put a business into liquidation. It was extended to include some AIM stocks that meet certain criteria. A qualifying company must have a proper trading business such as a pub, a manufacturer or a retailer.

In a new report, The Office of Tax Simplification (OTS) last week said that BPR wasn't necessary to prevent a business from being broken up or sold in order to fund the payment of inheritance tax.

It added: 'This raises a question about whether it is within the policy intent of BPR to extend the relief to such shares.'

There have been some recent concerns that the Labour Party would ditch the tax break if it got back into power. The OTS's remarks will certainly add fuel to this fire.

The tax perk has been a major revenue driver for asset managers which run IHT portfolio services. Among them is Octopus Investments whose head of tax products, Paul Latham, implies it is still business as usual.



**There are no recommendations to withdraw it, but this space needs to be watched closely**

He states the report doesn't recommend any changes but one cannot help feel that the OTS's remarks may have set the stage for the Treasury to undertake a proper review.

Chris Boxall, who runs the *Investor's Champion* AIM IHT search tool, says BPR has never been wholly relevant to AIM in terms of preventing a business from being broken up or sold in order to fund the payment of inheritance tax.

He adds: 'The relief in respect of smaller listed growth companies is surely in place to attract third party investment and there are indications that the Treasury has always considered it thus.'

Investors should not ignore the risk of the tax break being withdrawn, despite suggestions that AIM-related BPR is here to stay.

It is also worth considering that a large number buying stocks for IHT reasons are older people for whom AIM-quoted investments may not be suitable, given how many of the companies are higher risk in nature.

[Click here](#) to read a longer article on other elements of the OTS's review into the inheritance tax system.



By **Daniel Coatsworth** Editor

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# Hopes of US rate cuts recede on jobs spike

Employment and inflation suggest no need for Fed to ease policy

**M**arkets have been thrown into confusion after the US non-farm payrolls showed a much larger increase in hiring than analysts had expected, raising fears that the US Federal Reserve might not cut interest rates at its meeting on 31 July.

Such is the 'looking-glass world' that markets are experiencing that bad economic news is considered good for stocks if it increases the chances of an interest rate cut and good economic news is bad for stocks as it might delay a cut in rates.

## WHY DO PAYROLLS MATTER?

Every month the Bureau of Labour Statistics collects data on the number of new jobs created in the US public and private sector across all industries excluding agriculture.

In theory, because the data is backward-looking instead of forward-looking – unlike the purchasing managers' index (PMI) which is tracked each month – it shouldn't have that much influence on markets.

However, after May's dismal reading showed just 72,000 new jobs being added to the economy, analysts and investors had assumed that a 0.25% cut in rates this month was 'a given'. Sadly nothing in markets is ever a given.

In general, when 200,000 new jobs or thereabouts are being added to the economy every

month, the situation is considered to be 'healthy'. So when the figure came in at 224,000 last week, with the market pricing in a much lower number, investors were clearly rattled and stocks were sold off.

US interest rate expectations have undergone a remarkable change in the last six months. Instead of a rise in interest rates, markets had been discounting several interest rate cuts instead.

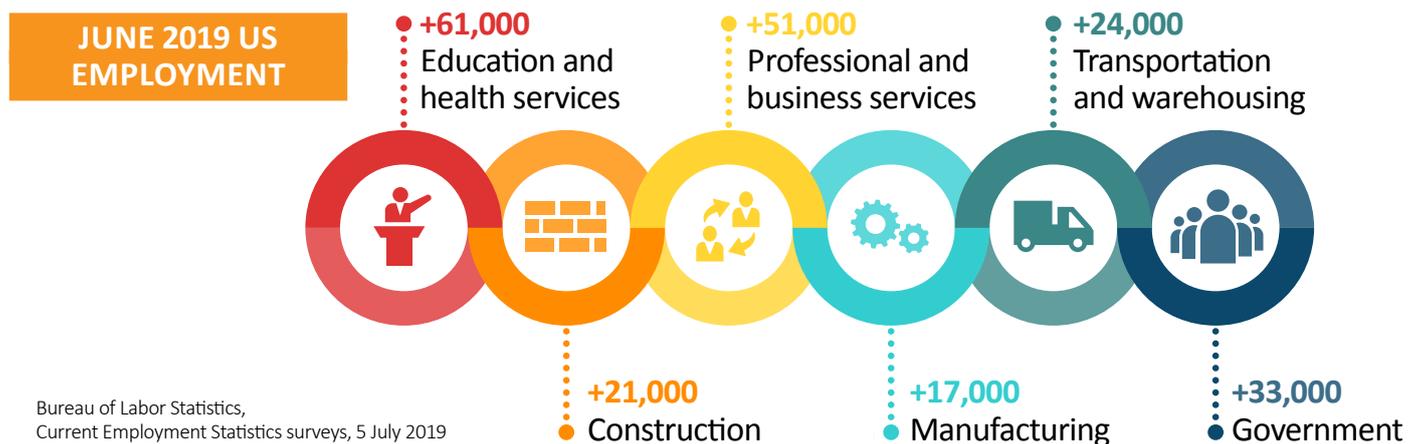
## ARE RATE CUTS OFF THE TABLE FOR NOW?

Experience suggests that one set of jobs data is unlikely to change the Federal Reserve's thinking on interest rates either way.

Looking at the rest of the non-farm report, the unemployment rate actually rose slightly from 3.6% to 3.7%, although it is still close to record lows, while annual wage growth was flat at 3.2%.

On the face of it the jobs market would seem to be in rude health and not in need of a rate cut to stimulate hiring. Meanwhile food and energy prices are rising by less than 2% and are not expected to pick up in the near future.

However with the US stock market trading at all-time highs and analysts and investors banking on a rate cut this month, the Federal Reserve has a tough decision to make. The economy may not warrant a rate cut for now but markets are likely to sell off hard if one isn't forthcoming.



# Deadline looms to take part in Whitbread's £2bn tender offer

We look at the options for shareholders as the leisure group seeks to return money from the sale of Costa Coffee

**S**hareholders in Premier Inn owner **Whitbread (WTB)** only have days to decide if they want to sell some of their shares back to the company as part of a £2bn tender offer.

The tender offer is a way of returning some of the proceeds from Whitbread's £3.9bn sale of Costa Coffee to Coca-Cola earlier this year.

Whitbread's official deadline to take part in the tender offer is 1pm on 19 July but many investment platforms want shareholders to vote by an earlier deadline, some as early as 16 July.

Shareholders taking part in the tender offer will get their cash from 30 July.

Companies often return cash from disposals to shareholders via special dividends. Whitbread has instead opted for a tender offer as it is more tax-efficient for many of its shareholders who own the stock outside of an ISA or SIPP.

A tender offer is subject to capital gains tax. UK residents have a £12,000 annual capital gains allowance, whereas they only have a £2,000 annual dividend allowance.

For those with capital gains or dividends exceeding their annual allowance, the Whitbread tender offer could still be a better option from a tax perspective. For example, higher rate taxpayers pay 20% for capital gains and 32.5% for dividends.

Shareholders taking part in the tender offer won't know the exact price at which their shares will be bought until 22 July.

They can either submit a tender to sell some or all of their shares at whatever price is ultimately determined, capped at £50.

Or they participate in the tender offer at a range of prices based on between a 0% and 5% premium to the volume-weighted average price over the five days to 19 July, again no higher than £50.

Alternatively, shareholders can choose to do

nothing and retain their existing holding.

Whitbread has already spent £480m from the Costa proceeds on share buybacks and says it will consider another programme to return cash should the current tender offer fail to attract demand for the full £2bn target.

Shares in Whitbread trade at £48.09 at the time of writing and have risen by 20% in value in the past 12 months.

Following the sale of Costa, Whitbread now consists of 1,200-plus Premier Inn hotels and restaurants across the UK and one hotel in Germany, with plans to expand to more than 30 sites in that country by 2020/21. Its casual dining brands include Beefeater and Brewers Fayre.

A first quarter trading update on 19 June revealed a 4.6% decline in like-for-like sales for UK accommodation and a 2.1% drop in food and beverage like-for-like sales. Chief executive Alison Brittain said she was cautious about short-term market conditions, but remained confident about longer-term growth plans in the UK and Germany.

## WHITBREAD IN FIGURES

- More than 35,000 employees
- Over 1,200 Premier Inn hotels and restaurants
- Serves over five million customers each month



# FTSE 100 miners on the charge as iron ore hits five-year high

Shares in BHP, Rio Tinto and Anglo American could benefit from resilience in the metal

**T**he price of iron ore recently hit a five-year high and some have tipped it to stay higher for longer, spelling good news for the likes of **BHP (BHP)**, **Rio Tinto (RIO)** and **Anglo American (AAL)**.

Many believe the boom time for iron ore miners won't last but there are reasons to believe the price of the metal could stay higher for longer than people expect.

Iron ore prices have climbed almost 70% this year and rose to a five-year high last week, reaching \$126 a tonne thanks to increased Chinese steel demand and lower supply from the largest producers, Brazil and Australia.

China accounts for around half of global steel output, so any fluctuations in its demand for iron ore – the key ingredient in making steel – can have a big impact on the market.

Thanks to supply issues, analysts at Jefferies expect iron ore to hover around the \$110 a tonne mark for the rest of the year, and remain elevated at around \$98 a tonne next year, even if demand softens.

Problems at Brazil-listed miner Vale, which halted some iron ore production after the tragic dam collapse at one of its mines in January, as well as production issues at BHP and Rio Tinto mines in Australia – three of the largest iron ore miners in the world – have taken a significant chunk of supply out of the market.

Despite their problems, BHP and Rio Tinto have both been beneficiaries of the deficit they've helped create, with their shares up around 20% to £19.85 and 24% to £48.29 respectively in the year-to-date.

Anglo American, another major iron ore producer, has also done well this year with its shares up around 20% to £21.38.

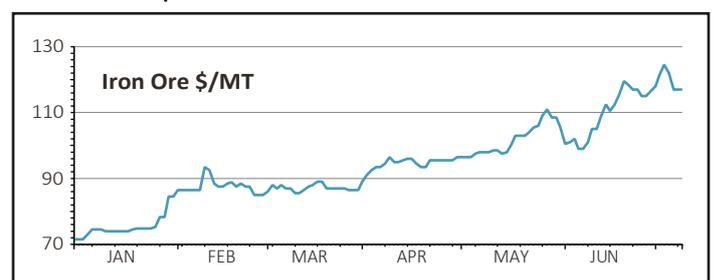


BHP is benefiting from the five-year high in iron ore prices

There are concerns however that the rally in their share prices is only temporary, and they could fall as rapidly as they've risen.

Part of this is due to anticipated weaker demand from China, as well as tightening environmental rules and higher taxes in countries like Brazil and Australia.

However, a dramatic drop in Chinese iron ore stockpiles has seen inventories hit a two-year low. That means, in the view of analysts, even if demand softens there still won't be enough supply and so the price of iron ore will remain resilient.



# Bovis, Persimmon, Imperial Brands and other big news

We look at the market risers and fallers from the last week

**T**here was a contrasting tone in the latest updates from housebuilders **Persimmon (PSN)** and **Bovis Homes (BVS)**.

On 4 July Persimmon announced a 4% decline in first half revenue as the company slowed its sales ambitions under new CEO Dave Jenkinson in order to get its house in order.

This should have come as little surprise as a series of issues around executive pay and customer care put its right to sell homes under the Help to Buy scheme under scrutiny.

In a sense Persimmon is at the start of a journey already taken by Bovis under Greg Fitzgerald who assumed control of the operator in 2017. At Bovis he has helped address build quality problems and other operational challenges.

The average private sales rate per site per week at Bovis rose 15% to 0.6 in the first six months of 2019 although investors may have been frustrated at the lack of explicit guidance on margins.

Both companies are trading on substantial prospective dividend yields – Persimmon is on 12.5% and Bovis is offering 10.1%.

Another high-yield income stock, **Imperial Brands (IMB)**, was actually rewarded for making its



dividend policy less generous on 8 July.

While the 2019 dividend will increase by 10%, in line with expectations, from that point on the company is only committing to an increase in its annual payout in line with earnings growth.

The stock advanced to the £20 mark as investors welcomed an approach which was seen as more sustainable in the longer term.

Elsewhere, oil firm **Energean Oil & Gas (ENOG)** struck an \$850m deal for EDF Energy's oil business (4 Jul). The transaction will be financed through a \$265m fundraise and \$600m loan.

Currently focused on developments in Israel and Greece, the acquisition will add production and development assets in Egypt, Croatia, Italy and Norway. The news got a positive reception with the shares moving higher to 982p.

## FTSE 350 MOVERS OVER THE PAST WEEK

### BEST PERFORMERS

STOCK	SHARE PRICE RISE	REASON
Energean Oil & Gas	16.8%	\$850m acquisition of EDF oil assets
Funding Circle	12.7%	Recovery after hitting fresh lows on revenue warning
Bank of Georgia	6.2%	Investors react to loan which has improved capital position

### WORST PERFORMERS

STOCK	SHARE PRICE FALL	REASON
GVC	-11.5%	Questions over circumstances of sale of Turkish business in 2017
Metro Bank	-9.7%	Reports of a boardroom bust-up
Spectris	-9.2%	Broker downgrade

Source: Shares, SharePad

# Grab Polar Capital tech trust while it is going cheap

The fund is trading on nearly twice its average discount to NAV

**T**he world is changing at its fastest pace than at any time in history and technology shifts and developments sit smack bang at the heart of this transformation.

Technology is everywhere and there are market beating returns to be had from investing in the space, even for the more cautious investor. This is where an expert team can help and Ben Rogoff has been running the **Polar Capital Technology Trust (PCT)** for getting on for two decades.

His track record speaks volumes about his market savvy. Over the past five years he has overseen a 185% increase in net asset value (NAV), beating his chosen Dow Jones World Technology benchmark by more than a fifth. Up to the end of 2018 the trust's 10 year NAV performance was 551%, ahead of the benchmark's 423% return.

You won't be surprised to find most of the world's largest and best known companies, including Google parent Alphabet, Microsoft and Apple as the three biggest holdings. Being 'benchmark aware' means some very large technology stocks simply must be owned.

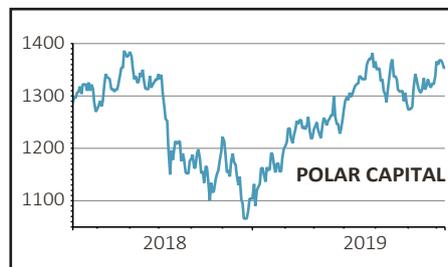
But what we really like about Rogoff is his willingness to adapt the portfolio as circumstances change and new opportunities emerge. This is brilliantly illustrated in how Polar Capital

## POLAR CAPITAL TECHNOLOGY TRUST BUY

(PCT) £13.52

Stop loss: £10.82

Market value: £2.04bn



Technology has slashed exposure to Facebook as it became embroiled in scandal over consumer privacy pressure.

Similarly, Microsoft has been increasingly backed as its cloud computing and artificial intelligence engine opportunity has stood out. Rogoff has also invested in some of the big Chinese technology growth stocks, such as Alibaba and Tencent, both in the portfolio's top 10 stakes.

But there are plenty of overweight holdings (meaning they are a higher proportion of the trust than in the benchmark) that are less widely known.

These include chip maker Advanced Micro Devices and software stocks like Alteryx, Twilio, New Relic and Hubspot that tap into many of his core technology themes, such as cloud computing, complex microchips, artificial intelligence, automation and disruption.

Many of these terms have become part of everyday conversation and even the most traditional of businesses, organisations and people are being touched by the tech bug.

The past year has seen some extreme spells of volatility in technology markets widening the trust's discount to NAV which currently stands at 8.9% versus a 4.8% average discount over the past 12 months.

Even so, Rogoff remains as chipper about the long-run prospects for select technology themes as ever. We believe this makes the Polar Capital Technology Trust an excellent long-run value creation investment option.



By **Steven Frazer**  
News Editor



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# ISSUE OF NEW SHARES

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# Logistics firm set for re-rating after completing turnaround

No-deal Brexit likely to encourage even greater stockpiling ahead of October deadline

**A**s the largest British logistics company, Wincanton (WIN) received plenty of media coverage in the first quarter of the year as the nation prepared itself to exit the European Union on 29 March.

With 14.3m square feet of warehousing space across more than 200 locations and a fleet of 3,600 vehicles, Wincanton was a prime beneficiary of the stock-piling frenzy which saw companies and consumers hoard everything from drugs and machine parts to mozzarella sticks and Magnum ice creams.

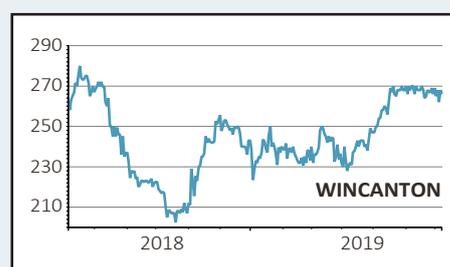
On top of the Brexit-induced rush of orders, Wincanton won several new contracts with high-profile customers such as Co-op, EDF Energy, HMRC and Weetabix as well as extensions or renewals of existing contracts with major clients including Asda, **Halfords (HFD)** and Lucozade Ribena Suntory.

The firm is in a materially stronger financial position than it was four years ago with debt down to just £26m or 0.3 times earnings before interest, taxes, depreciation and amortisation (EBITDA) versus £202m or 3.1 times EBITDA in 2015.

Also a more disciplined approach to winning contracts,

**WINCANTON**  **BUY**  
(WIN) 261p  
Stop loss: 209p

Market value: **£321**



a move into higher-value areas of logistics like e-commerce and tighter cost management means margins have grown to an all-time high of 4.8%.

With the turnaround complete, a new chairman was appointed last August and a new chief executive is due to start this September with a focus on growing the firm's revenues.

At the full year results in May, the chairman promised to 'deliver much better value for shareholders in the years ahead'.

Wincanton's business model covers the staples of consumption in the UK giving it stability whatever decisions are made affecting trade with other countries.

Its operations are almost entirely UK-based (Ireland represents 1% of sales) and most of its existing contracts have provisions which allow for movements in prices including fuel to be charged to its customers. Nearly two thirds

of its contracts are 'open-book' meaning Wincanton is not directly impacted by increased costs.

The firm believes there is potential for additional demand for its services under most Brexit scenarios, in particular for warehouse space, container storage and transport services.

With no-deal Brexit being kept on the table over the summer there is a distinct likelihood that consumers and businesses will begin stockpiling again ahead of the October exit date but this time on a much larger scale. Naturally that would play to Wincanton's strengths.

Trading on less than 8 times 2020 earnings the shares are considerably cheaper than other logistics and warehouse stocks like **Tritax Big Box REIT (BBOX)** and look primed for a re-rating.



By **Ian Conway**  
Senior Reporter

## SCOTTISH MORTGAGE

(SMT) 548p

**Gain to date: 13.9%**

**Original entry point:**

**Buy at 481.4p, 18 October 2018**



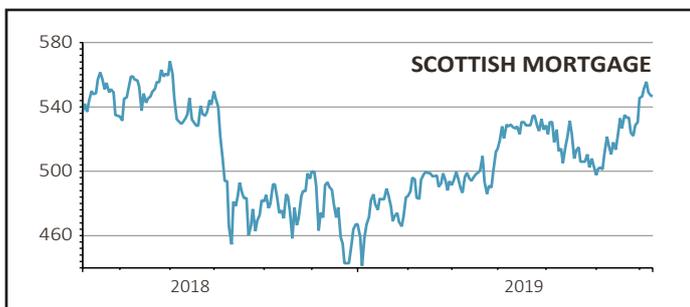
SHARES IN TECHNOLOGY-FOCUSED investment trust **Scottish Mortgage (SMT)** recently hit a nine-month high as it continues to reward our buy call in the wake of a big sell-off last autumn.

The usual premium to net asset value (NAV) status enjoyed by the fund has been restored as investors continue to back the stock picking skills of long-serving manager James Anderson.

This remains a highly concentrated portfolio with around 45 holdings and is focused on capital gains rather than income with a modest dividend yield of 0.6%.

A significant factor in the strong recent performance has been the recovery in US stocks, with the US accounting for more than half the portfolio. In particular, a share price recovery in electric car manufacturer Tesla has helped Scottish Mortgage given it represents 3.7% of the trust's portfolio.

Tesla, which had been a target for short sellers, has rebounded thanks to higher-than-expected delivery numbers in the second quarter.



### SHARES SAYS: ↗

Dampened hopes on rate cuts have seen US shares stall but Scottish Mortgage has a long-term investment horizon and continues to be a good buy for an investor operating on a similar time frame.

## BIGBLU BROADBAND

(BBB:AIM) 108p

**Gain to date: 1.9%**

**Original entry point:**

**Buy at 106p, 21 February 2019**

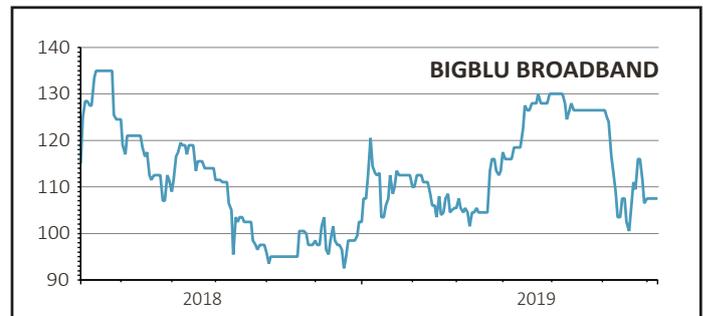
INVESTOR ENTHUSIASM for **Biglu Broadband's (BBB:AIM)** superfast satellite internet access story has ebbed again after the shares' strong April rally, but the underlying trends look very positive.

Net new customer growth is accelerating and gross margins are on the rise, up from 37.4% to 43.7% for the half year to 31 May. What this tells us is that Biglu is seen as a competitively-priced supplier for an increasing number of consumers living in the relative sticks and with limited alternative options to get superfast broadband.

It helps that more and more people want access to streaming services like Netflix, Amazon Prime or Now TV and are happy paying more for the privilege. Biglu's new 50Mbps download speed and unlimited usage package could really strike a chord with users.

Some investors might fret about the £5m jump in net debt to £16.9m, but we believe that tallies with the extra working capital needed to support faster customer growth. There are also earn-out payments from past acquisitions to factor in.

Full year estimates call for £10.1m of EBITDA (earnings before interest, tax, depreciation and amortisation) on £62.5m of revenue. So the half year's £4.3m EBITDA and £30.5m revenue equates to 43% and 49% of the respective full-year forecasts.



### SHARES SAYS: ↗

There's still work ahead to hit expectations but the underlying trends are very promising. Still a buy.

## PERSHING SQUARE

(PSH) £14.42

**Gain to date: 7.9%**

**Original entry point:**

**Buy at £13.36, 16 May 2019**

OUR BULLISH CALL on Bill Ackman-managed **Pershing Square (PSH)** looks well-timed with the shares already up 7.9%.

Last month (19 Jun), Pershing Square announced a bumper \$100m share buyback of its shares on the London Stock Exchange and Euronext Amsterdam and the positive news flow continued with the performance report for June.

Pershing Square's 8% monthly gain means the fund's NAV rose by a stunning 45.3% in the first half of 2019, dramatically outperforming the S&P 500.

An investment trust that makes concentrated investments in North American-domiciled large caps, we feel Pershing Square's excessive discount to net asset value (NAV) fails to reflect the quality of the underlying portfolio managed by Wall Street billionaire Ackman's Pershing Square Capital Management.

The activist investor puts money to work in companies that generate relatively predictable, growing free cash flows with 'formidable barriers to entry and a compelling value proposition'.

Pershing Square's recent success reflects the outperformance of the likes of tacos-to-burritos chain Chipotle Mexican Grill and coffee chain mega-cap Starbucks among others.



**SHARES SAYS:** ↗

Bill Ackman is having his best year ever, which means Pershing Square's massive 25.6% discount to NAV is anomalous. We remain excited by the quality and potential of the concentrated underlying portfolio.

## TELECOM PLUS

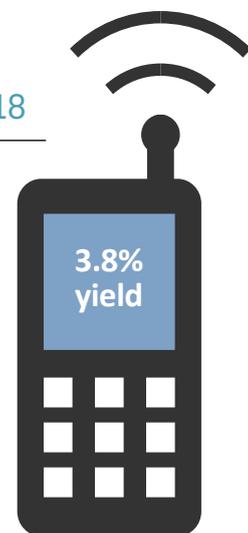
(TEP) £13.94

**Gain to date: 2.2%**

**Original entry point:**

**Buy at £13.64, 6 December 2018**

AT A TIME when some historically reliable income paying stocks have disappointed, the value of dividends from multi-utility supplier **Telecom Plus (TEP)** should not be underestimated. The 52p per share dividend paid to shareholders for the year to 31 March 2019 would imply a very decent inflation-busting 3.8% yield on our original entry price last December, and growth is set to accelerate.

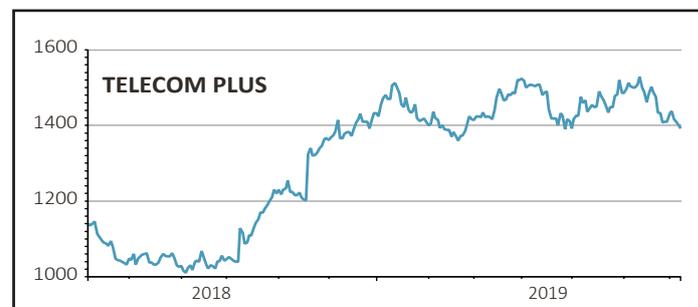


Analysts have forecasts dividends worth 56.1p for the current financial year and 64.5p next financial year, both implying attractive returns versus the dismal rates you'd get on cash savings.

The latest financial results detailed modest growth in revenue (£804.4m) and adjusted pre-tax profit (£56.3m) but that was in the face of an exceptionally mild winter that meant far less gas demand.

The new energy price cap is also an issue to stomach, although management believes it makes the industry fairer.

Telecom Plus says its customer churn rate has remained steady at around 12% a year, which it claims to be half the average rate across the energy sector.



**SHARES SAYS:** ↗

The company remains a solid growth and income play. Keep buying.

# UK construction companies face tough time

We look at the exposure of London-listed stocks to mounting domestic pressures

A disappointing trading update from building materials firm **SIG (SHI)** on 5 July was the latest bit of bad news from the UK construction sector. It follows a series of negative data points and gloomy commentary from construction companies.

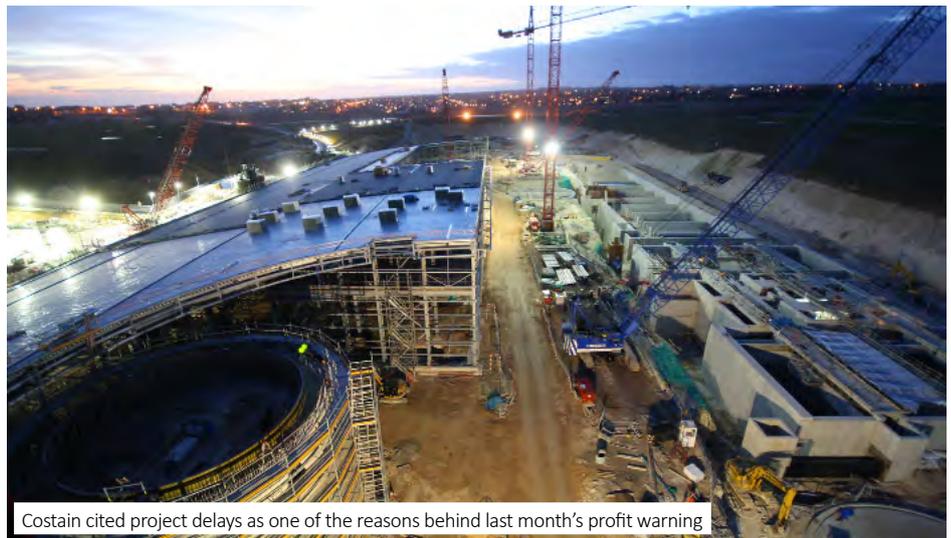
In this article we look at some of the larger businesses in the construction and building materials space and consider how diversified they are geographically and if there are any parts of the space which have firmer foundations.

## AN INDUSTRY IN TURMOIL

SIG, which specialises in areas like roofing and insulation, reported a 12.7% drop in like-for-like revenue from its UK operations in the first half of 2019.

This followed hot on the heels of PMI (purchasing managers' index) data on the UK construction sector which showed June was the industry's worst month since April 2009. A reading of 43.1 was down from 48.6 in May and well below market expectations of 49.3.

Based on a survey of purchasing managers – who are the people responsible for buying in the goods and services required for a firm's day-to-day operations – any figure above 50 implies growth whereas any number below this threshold



Costain cited project delays as one of the reasons behind last month's profit warning



indicates contraction.

Recent wet weather may not have helped the latest reading, but this still represents an alarming slump. Furthermore, the downward pressure is evident across the board. Housebuilding posted its largest decrease in three years while the other two categories – commercial and civil engineering work – also fell.

The news suggests uncertainty over the outcome of Brexit is

leading to project delays and this puts suppliers in a tricky spot. They need to reduce capacity to keep control on costs while remaining prepared to service any rebound in demand if there is greater clarity on the political situation.

The uncertain backdrop is not just affecting work in the private sector. Infrastructure play **Costain (COST)**, which works on projects for the likes of Network Rail and Highways England, was another name in this space to take a big hit as it last month warned on profit, citing project delays.

Meanwhile **Kier (KIE)**, once a heavyweight in the space, continues to limp along in heavily diminished fashion, recently suspending dividends and announcing 1,200 job cuts under new CEO Andrew Davies as it tries to get borrowings under control.

## LONDON-LISTED CONSTRUCTION FIRMS' UK EXPOSURE

Company	Share price year-to-date	UK as % of total revenue
Ibstock	19.1%	100%
Galliford Try	-0.3%	100%
Marshalls	40.9%	95%
Polypipe	31.7%	89%
Balfour Beatty	-3.7%	46%
Hill & Smith	-3.1%	45%
Kingspan	28.2%	21%
CRH	27.6%	12%

Source: 2018 annual reports, SharePad (Share price data to 8 Jul 2019)

### STOCKS WITH BIG UK EXPOSURE

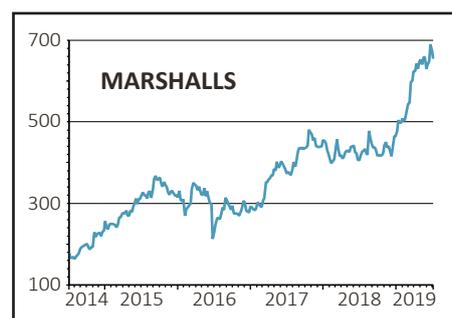
The threat of political intervention and the nationalisation of certain assets if the Labour Party wins the next general election is another factor to consider for companies with exposure to the UK public sector.

Construction, regeneration and housebuilding all-rounder **Galliford Try (GFRD)**, paving and road specialist **Marshalls (MSLH)**, pipe specialist **Polypipe (PLP)** and brick manufacturer **Ibstock (IBST)** are particularly dependent on the UK for their revenue.

Ibstock benefits from strong market dynamics with a limited supply of bricks in the UK but would be materially affected by a slowdown in housebuilding activity. Its half year results are published on 31 July.

Marshalls has been a consistent performer which is

reflected in a strong share price performance. The track record has been built on targeting niche areas which are likely to enjoy growth, however a broad-based slowdown in construction could be negative for the business.



### GREATER DIVERSIFICATION

**Balfour Beatty (BBY)** and road and rail project specialist **Hill & Smith (HILS)** both have significant footprints in the US, while **CRH (CRH)** carries the least exposure to the UK, although it is still a material bit of the business at 12% of 2018 revenue.

Kingspan made 21% of its

revenue from the UK in 2018. It is a leading operator in high performance insulation. It has focused on playing the energy efficiency theme and has been boosted by regulatory drivers in this space.

However, even for businesses with niche specialisms and without substantial domestic exposure, there is a risk they could be caught up in negative investor sentiment towards the wider space. Investment veterans often observe that a good company in an unloved sector will underperform a bad company in a loved sector.

Kingspan and Marshalls could be particularly vulnerable should sector conditions get a lot worse given their premium valuations, trading on 23.4 times and 22.1 times forward earnings respectively.

### KEY UPCOMING COMPANY AND ECONOMIC DATA TO WATCH

**Galliford Try trading update**  
17 July

**Construction PMI data**  
2 August

**Balfour Beatty first half results**  
14 August



By Tom Sieber  
Deputy Editor

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# HOW THE CHANGING POLITICAL LANDSCAPE COULD AFFECT YOUR WEALTH



**BORIS JOHNSON**

**VS**

**JEREMY CORBYN**

**B**ritain's new prime minister will be announced on 23 July. Boris Johnson is widely considered to be the favourite and Jeremy Hunt the underdog.

Whichever candidate wins they face a baptism of fire as the 31 October Brexit deadline looms large on the horizon.

Johnson has made bold statements to the effect of Brexit or bust come Halloween. Hunt has been more circumspect, albeit playing to his audience by

underlining his no-deal over a no Brexit position.

Brits have been trapped in a minefield of uncertainty for three years and the end is not necessarily close. This leaves investors still facing many tricky questions on the UK economy, the prospects for share prices and investment incomes, plus a whole host of other investment issues.

So whatever your personal views on the best candidate for number 10, whether you think Brexit deal or no-deal (if it comes) will act as a

# BORIS JOHNSON

- ✓ Increase higher rate income tax threshold – good for many consumers
- ✓ Possible stamp duty cut – good for housebuilders and estate agents
- ✗ Risk of no-deal – bad for UK economy and the stock market, particularly the FTSE 250 and UK domestic stocks



# JEREMY CORBYN

- ✗ Renationalisation of utilities and transport companies – bad for shareholders of these stocks
- ✗ Higher taxes – bad for many consumers
- ✓✗ Greater government spending – good for infrastructure/construction companies, but bad for the country's financial situation



boost or brake to the UK economy, or if a general election is years away or just around the corner with labour's Jeremy Corbyn in the running as a future PM, this feature looks at six issues facing savers and investors.

## PLAYING TO THE CROWD

The final decision on who takes up residence in Number 10 later this month will be made by the 125,000 or so Conservative Party members.

Building wider popularity is also important for the longer-term. Both Boris Johnson and Jeremy Hunt have made various pledges to cut taxes for consumers and business, boost public sector funding and pay. We've also had pledges to bolster investment in key industries, such as fishing, farming, housing and defence, and increase private investor allowances.

Whether those promises become policies down the line is another matter, with even Chancellor Philip Hammond warning against what he views as 'reckless promises'.

## 31 OCTOBER IS LOOMING

'Taking recent comments from the leadership contenders at face value, we think there is a reasonable chance that a new Eurosceptic leader



will attempt to push for a no-deal Brexit if they are unable to rework the deal before the end of October,' say economists at investment bank ING.

John Curtice, professor of political science at Strathclyde University, argues there is little chance of any Conservative prime minister delivering on a promise to leave the EU without a deal on the current exit date of 31 October.

'Any prime minister who pushed for no-deal would see their government collapse in the autumn and risk a general election where there would be a significant chance that Labour would end up in government before the end of the year,' adds Curtice.

James Smith, ING's development markets economist, says a general election is the most likely scenario out of the ones his team have considered, 'but a more pragmatic approach certainly shouldn't be ruled out either'. His team puts the probabilities of a general election before the end of 2019 at about one-in-three.

'While the legislative options may be limited, there is one obvious way that parliament could block no-deal, and that's to try and force a general election,' say ING's experts.

This could be sparked by Corbyn calling for a motion of 'no confidence', and it wouldn't take many Conservative MPs to back it.

'Several moderate Conservative lawmakers have hinted they would be prepared to collapse their own government if that was the only way of stopping no-deal,' adds ING.

# SIX KEY ISSUES FACING SAVERS AND INVESTORS

## 1. A POTENTIAL CORBYN-LED GOVERNMENT

Many recent polls across the UK's electoral system suggest Boris Johnson could hypothetically secure an absolute majority for the party at the next election. But that outcome comes with several caveats, not least that electoral calculators can be relatively crude.

A failure to live up to promises of achieving Brexit by October would undoubtedly give leverage to the Brexit Party and likely cost Johnson dearly.

'A lot would also depend on Labour's Brexit position – so far Corbyn has been reluctant to back a second referendum. But polls suggest that if he is to become prime minister, he would need to join forces with several other political parties (The SNP and Lib Dems certainly), almost all of which would set a second referendum as their price for a coalition arrangement with Labour.

Since those comments were made, Corbyn challenged the next Tory leader to hold another referendum before taking Britain out of the EU.



That makes it judicious for investors to start taking seriously the possibility of a change of government.

There is the likelihood that income taxes above the current 45% for higher earners would be on the cards under Labour. And capital gains tax would almost certainly come under the spotlight, with neither prospect likely to go down well with many investors.

## 2. PROSPECTS FOR UK STOCK MARKETS

You don't need Jon Snow's *Swingometer* to tell you that Boris Johnson could be seen as the better bet for UK investors than Jeremy Corbyn. We say that

from a neutral standpoint as *Shares* does not take sides with politics.

With Johnson, many people would view his victory as a path to less tax rather than tax hikes, pro-business rather than anti-enterprise, and reduced pressure on the public purse, not more.

The prospects of the UK stock market will be tied in with economic prosperity but the possibility of large scale re-nationalisation presents a particularly hot potato for investors.

Possible plans to take some industries out of private ownership and put back in the hand of a Labour government remain loose at present, although they are a clear risk if you're a shareholder in one of the affected companies.

The most likely targets include many of the UK's utility suppliers – gas, electricity, water, the railways and postal services – while even **BT (BT.A)** could be marked for renationalisation, if recent speculation is to be believed.



There has been some chatter that Labour could buy back assets at less than their current market value. But who knows how it would fund such renationalisation efforts.

### Deal or no-deal, impact on UK share prices

#### Deal

Pick up in GDP growth – Positive  
Appreciation of the pound – Negative

#### No-deal

Depreciation of the pound – Positive  
Economic slowdown – Negative

Source: Capital Economics



**“ AS OUTLINED IN INSUFFICIENT DETAIL, THE LABOUR PARTY’S SPENDING AND NATIONALISATION POLICIES COULD END UP WITH A FEW EXTRA HUNDRED BILLION OF DEBT ”**

The biggest likely impact of a widespread Labour-led renationalisation campaign would be the potential message it sends out to the wider world, and Britain’s reputation as a safe and fair destination for overseas investment.

More volatility in the UK stock market is anticipated in the short-term regardless of domestic issues given the global nature of many of our largest companies.

Somewhere in the region of 70% to 75% of revenue earned by FTSE 100 companies comes from overseas which makes things like global growth and the impact of trade tensions just as important, if not more so, to UK share prices as to the person in number 10.

### 3. GILTS AND GOLD

A Corbyn government post the next general election has the potential to send Gilt (UK government bond) yields soaring (and prices falling), according to experts at Kames Capital. Markets fear the worst over spending and nationalisation plans, but that outcome is far from clear.

The recent rally in global bond markets has pushed out expectations of higher UK rates, with some experts predicting a 25 basis point cut if a no-deal Brexit comes to pass.

‘As outlined in insufficient detail, the Labour Party’s spending and nationalisation policies could end up with a few extra hundred billion of debt on the Bank of England’s balance sheet,’ says Adrian Hull, head of fixed income at Kames Capital.

The Bank of England already has £425bn of Gilts but these were purchased from the market

in return for cash for investment elsewhere, according to Hull. ‘The Labour Party has spending plans that will be materially beyond that of the current budgetary balances, and further debt is likely to be issued (or created at the Bank) due to nationalisation programmes.’

Gold is seen as a sensible asset to own when the future is gloomy or unpredictable, and it’s worth noting gold recently hit a seven-year high.

### 4. THE POUND IN YOUR POCKET

Sterling moves up and down depending on the attractiveness of the UK economy but there are so many moving parts that it becomes a very complex topic.

In the short-term Brexit remains the driving force behind sterling and there is little doubt that a no-deal outcome would hurt the pound. ‘A no-deal Brexit could potentially hurt the euro as well, but by nowhere near the same level,’ adds Investec foreign exchange dealer Chris Brand.



Make UK, which represents 20,000 UK manufacturers, has said it would be 'the height of economic lunacy' to take the UK out of the EU without a deal in place.

But while the UK's future relationship with the EU dominates the UK debate, currencies move for a variety of reasons. 'While Brexit will be an obvious focus, future relationships with potential trade partners will also be important,' says Brand. 'Johnson, for example, might not be liked by the EU, but he would be liked by US President Donald Trump.'

It is tricky to assess a Corbyn government's impact on sterling but the likelihood would be further weakness in the short-term with investors likely to anticipate a period of economic instability, but trying to predict the pound's trajectory into an already opaque future is a fool's errand.

All the more reason to take the longer view on investment markets and not be too swayed but near-term political uncertainty.

Some experts anticipate the pound to rally at some point but more important is that UK investors are globally oriented, and unencumbered by home-country biases even if returns and performance are usually referenced in sterling.

## 5. DIVERSIFICATION, THE FIRST RULE OF INVESTING

Diversification is designed to cap exposure to the threat of setbacks or failure at any one company or country. It is a tried and tested way to cope with the uncertainty inherent in life, politics and the stock market.

It can be achieved in all sorts of ways but is perhaps easiest to manage through a good selection of funds that give investors exposure to equities and stock markets around the world,



## BREXIT POSSIBLE OUTCOMES AND CHANCES

### Parliament forces a general election 35%

Parliament stops a no-deal by passing a confidence motion. General election takes place in late November or early December

### Revamped deal 25%

To avoid a general election at all costs, pro-Brexit MPs reluctantly back a tweaked deal given there's a Brexiteer prime minister in place for next stage of trade talks

### Second referendum 15%

Parliament may struggle to force a 'People's vote', but cannot fully rule out the prime minister triggering one as the 'least worst' option versus a general election

### No-deal 20%

If the EU rejects a further Article 50 extension or a new leader pushes for a hard Brexit, parliament may lack the legislative tools to stop it

### Revoke Article 50 5%

Parliament may prefer this option over a no-deal exit, but like a second referendum, MPs could lack legislative tools to force the new prime minister's hand

Source: ING

non-equity assets such as bonds, property and currencies, and even holding cash at times.

There is actually an inherent diversification built in to the FTSE 100 because of the overseas income its constituents generate, so it makes little sense to base investment views on the UK in isolation.

For example, between 2014 and 2015 the UK and US economies both grew at around 2.6% per year, according to Ben Kumar, investment manager at Seven Investment Management, while interest rates and inflation were similar. But those two years were bad for oil prices, which fell by more than 60%.

'From an economic standpoint, oil is marginal to both the US and the UK economies. Yet in those two years the US equity market rose 11% while the UK equity market fell 8%,' he explains.

Kumar's analysis says that the near-20%

difference in performance between the two indices had little to do with the economies of the two countries, and far more to do with how certain sectors have a large influence on stock markets.

'Oil companies make up nearly a third of the FTSE 100 and fell by about 30% between 2014 and 2015 and this pulled the overall market right down. American energy and materials companies felt the same pain, but because they make up less than 10% of the US stock market the impact was less severe,' he explains.

'Many assume one's asset positioning should be defensive during times of heightened geopolitical conflict,' says Kleinwort Hambros' Kamal. 'History teaches a different lesson, with geopolitics rarely impacting equity markets over the medium to long term of five to 10 years.'

## 6. HOW COULD BORIS OR CORBYN CHANGE OUR PERSONAL FINANCES?

### Boris Johnson

He wants to hand a £9bn tax boost to 4m higher earners by raising the 40% higher-rate tax threshold from £50,000 to £80,000. This could benefit the top 10% of earners to the tune of almost £2,500 a year.

Pensioners enjoying high incomes could be the big winners as they won't be affected by Johnson's plan to raise the National Insurance ceiling to help pay for the measure.



Johnson has signalled his intention to raise the level at which NI payments kick in. The IFS believes every £1,000 increase in the level would cost about £3bn a year.

Johnson is rumoured to be in favour of scrapping



stamp duty on homes worth less than £500,000. This would represent a major giveaway of up to £10,000 for first-time buyers and £15,000 for other property buyers.

### Jeremy Corbyn

Labour has set out plans to bring the 45% income tax threshold down to £80,000 and introduce a new 50% rate for those earning over £123,000.

Shadow Chancellor John McDonnell is eyeing a 'wealth tax' which could look to seize 20% of the assets of the richest 10%.



Further changes to retirement savings incentives could be on the cards, presumably focused squarely on higher and additional-rate taxpayers.

Labour is expected to freeze planned increases in the state pension age beyond 66 and look at ways to develop a flexible system which takes account of life expectancy variations.



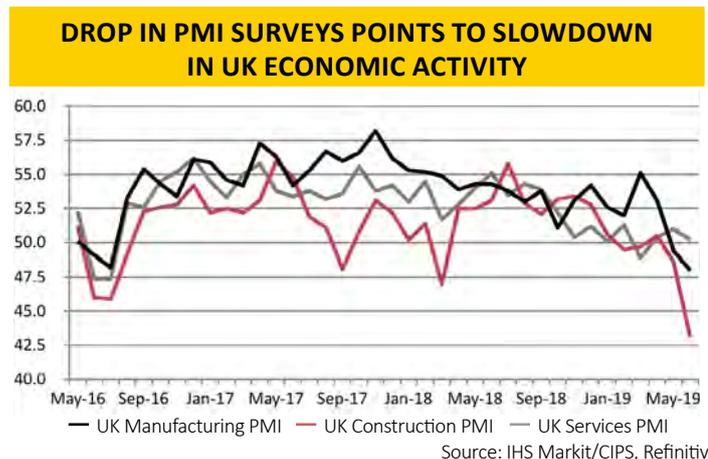
By Steven Frazer News Editor

# What sort of economy will the new Prime Minister inherit?

We look at the current state of affairs and how they might change in the near and medium-term

**A**s they continue to jostle for position, Boris Johnson and Jeremy Hunt are starting to outline their policies on tax and spending, areas that could both have an influence on the trajectory of the UK economy, regardless of whether Brexit happens on 31 October or not.

It is therefore worth taking stock of how the UK economy looks right now to see what the new Prime Minister will inherit. At first glance, the omens are not great. The latest purchasing managers' indices showed a slowdown in manufacturing and a slump in construction, as well as a near-stalling of activity in the dominant services sector.



**HOW DO YOU CALCULATE GDP?**

**Consumption + investment + government spending + exports – imports**



Whether this is down to Brexit or a wider global slowdown is not easy to divine. If the monthly PMI surveys prove to be a reliable guide then the UK economy could shrink in the second quarter versus the previous three months – the first such drop since the fourth quarter of 2012.

There has been a deceleration in growth of household consumption since the Brexit vote in summer 2016 to a run-rate below 2%.

The good news is that wage growth is nearing 10-year highs and outpacing inflation. Proposed tax cuts from the Conservatives could add around 1.5% to household income, although Labour's proposed tax increases could take off around 1.0%, according to estimates from Capital Economics.

Interest rates could go down before they go up, depending on Brexit. Perhaps a bigger wild card is the savings rate which at 4% of disposable income is near historic lows and any increase could act as a brake on spending.

**“ THE GOOD NEWS IS THAT WAGE GROWTH IS NEARING 10-YEAR HIGHS AND OUTPACING INFLATION ”**

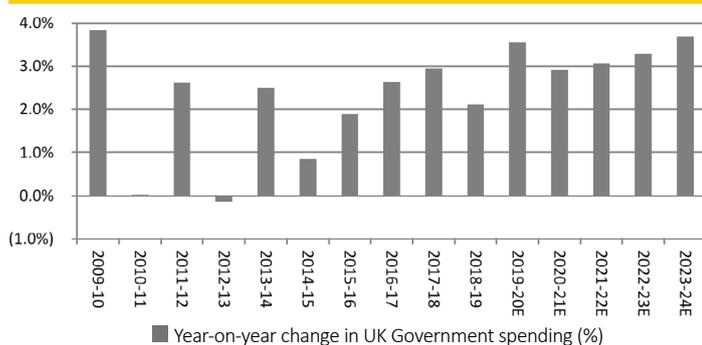


Investment also appears to have slowed ahead of Brexit. This can be seen in the manufacturing PMI but also the investment intentions reading from the Bank of England’s agents survey.

If businesses get some degree of visibility over Brexit, they may start to loosen the purse strings but the risk is that the global economy slows. This is something that we could already be seeing, judging by the easing in capacity constraints shown by the same Bank of England report.

Growth in Government spending looks set to accelerate, given Johnson and Hunt’s policy plans – and that is before anyone dips into Chancellor Philip Hammond’s £26bn of fiscal headroom. This is not a pot of cash, but extra spending that would take the UK’s annual budget deficit back to 2% over the next five years.

**GOVERNMENT SPENDING GROWTH LOOKS POISED TO ACCELERATE**



Source: Office for Budget Responsibility, Office for National Statistics, forecasts from 2019 Spring Budget

A Labour government could lead to another step up, although increased taxation could have some impact on consumer and corporate spending.

Export growth has sagged of late while import growth has surged. The soggy exports may be the result of a global slowdown in business activity,

which is becoming more marked as a result of trade disputes between the US and its major trading partners.

**GLOBAL ANGLE**

The UK’s fortunes cannot be seen in isolation. The identity of the new Prime Minister and his policies, the response of the EU and Westminster to Brexit and the action they in turn prompt from the Bank of England provide plenty of variables. And that’s before the possibility of a Labour victory in a general election between now and 2022.

Then there is the issue of global growth on top – and this may be the most important of all, at least from a stock market perspective.

Two-thirds of the FTSE 100’s revenues come from overseas and there is little apparent correlation between UK GDP growth and the rate of change in aggregate FTSE 100 profits.

**UK GDP GROWTH SEEMS TO HAVE LITTLE BEARING ON FTSE 100 EARNINGS GROWTH**



Source: Office for National Statistics, FTSE 100 company accounts, Sharecast, Consensus analysts’ forecasts

**By Russ Mould**  
AJ Bell Investment Director

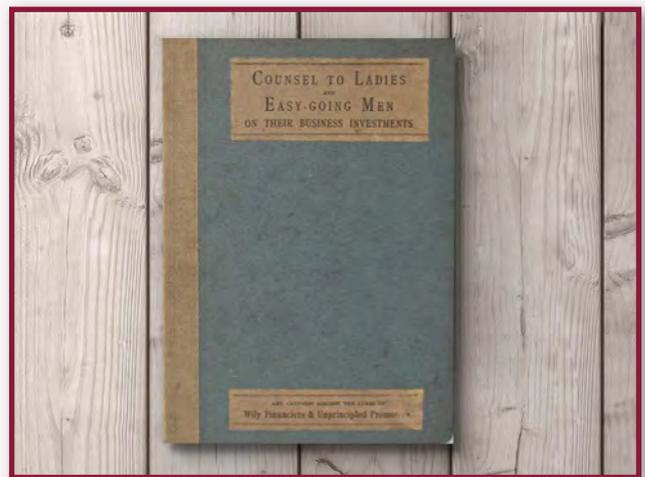
# Using the 1890s as a guide to bond investing (not the 1980s)

Jenna Barnard, Co-Fund Manager of Henderson Diversified Income Trust, reveals how a second-hand book published almost 130 years ago turned out to be a rare birthday present gem.

Last month, I received a birthday present of a singular little book dating from 1892, which was found by chance in a second-hand book dealer. **Counsel to Ladies and Easy-Going Men on their Business Investments and Cautions Against the Lures of Wily Financiers & Unprincipled Promoters'** turned out to be a personal guide to bond investing written by an anonymous woman based on her own investment experience in the late 1800s. Understandably, this might not appeal to everyone, but from my perspective it turned out to be a rare birthday present gem.

Its contents are not only instructive but bring illumination to the predicament facing bond investors more than a century later. It is worth noting that the book was written in the UK in 1892 in the midst of what was known as 'The Long Depression'. This period has many parallels to our own but hit the UK particularly hard as it became a pursued economy with its industrial hegemony eroded by the emergence of the US as a competitor. Globally, the 1870s, 1880s, and 1890s were a period of falling price levels and rates of economic growth significantly below the periods preceding and following. Triggered by financial crises (railroad bonds in the US, a silver crisis in Europe) and stagnant real wages there are many parallels to the current global malaise.

The book contains timeless investment precepts that have a healthy overlap with our own style of bond management, which we have termed "Sensible Income". This style reflects the needs of our clients, with the average investor in one income fund we run being named Margaret, who is 78 years old and lives in Bournemouth on the south coast of England. We imagine Margaret when selecting bonds for Henderson Diversified Income Trust (HDIV) and understand that she wants solid, dependable income prospects, not equity-type risk from her bond fund. We are bond managers and clients, in our view, do not want to be unsettled or stressed by the bond allocation in their portfolios. We leave that to other asset classes with the prospect of greater return in exchange for greater risk. Ideally, the bond allocation should provide diversification against risk assets and hence a degree of duration exposure can be very useful in turbulent times.



This approach is neatly summarised in the book:

*"Never expect to make money by a great coup; moderate risks and moderate profits from time to time are the only solid basis of permanent success. Great risks unsettle the judgment and usually end in disaster".*

What we find most gratifying is when we can see that this style of credit investing has even percolated through to our allocated investment bank salespeople when they quote back to us that "this bond would suit Margaret". In the book this is referred to as the behaviour of "the old race of merchants" who would "lay down certain principles of the conduct of their affairs, from which they would not deviate; when any unsuitable business was proposed, they at once replied that it was not in their line; it saved waste of time in considering the proposal...and saved them from many a loss".

In what follows I've chosen a few choice quotes from the book to reflect on:

## RECURRING TROUBLEMAKERS & GOVERNMENT BOND INVESTING IN EUROPE:

Northern Europe – *"Securities of good Continental Governments, such as Germany, Prussia, Holland and Scandinavia are too dear as a rule."*

*"France, Austria, Hungary and Italy, are honest, but they add to their debts year by year."*

Southern Europe – *"The government securities of the South of Europe, Spain, Portugal, and Greece are dangerous as permanent investments; from time to time they have compromised their creditors in the past, and will*

do so again.”

The relevance of these statements is obvious given the experience of Europe in recent years but it continues to amaze us that investors exhibit little long-term stewardship of their clients’ money or perspective during ‘hot’ markets. A classic case in point was the almost farcical Argentinian 100-year bond issued in 2018 and currently trading at 67 cents on the dollar<sup>1</sup>.

#### **CORPORATE BOND INVESTING:**

*“No investments are more dangerous for a lady than new banks and new insurance companies.”*

*“New banks at home or abroad are often started by second class people, and must be carefully avoided. Established and solid business firms do not readily change their bankers, so that many of the clients of a new bank are third or fourth rate firms; for some years usually bad debts are made, and the management has to buy its experience at a heavy, and sometimes ruinous cost.”*

This point is not lost on anyone who might have invested in bonds from Metro Bank, a UK challenger bank that was launched a few years ago.

*“Loans of small states and the securities of companies with small capital...are difficult of sale and the quoted margin...is usually considerable. Moderate stakes in large companies are the best.”*

We have also found the bonds of smaller companies to have higher default rates on average and lower recovery rates. Lending to a company with <US\$100m in EBITDA (earnings before interest, tax, depreciation and amortisation) is, in our view, best avoided.

#### **SHORT DURATION BOND STRATEGIES:**

*“Bonds to be paid off at par in a few years are not very desirable for ladies. If good they will have to buy at a premium, and will of course incur a loss of capital at the end of the term. They will then have the trouble of finding a new investment and as the interest on money may further decline, this may be a considerable disadvantage.”*

The issue of reinvestment rates is particularly pertinent today if, as we believe, the Federal Reserve has signalled that rates in the US have peaked at 2.4% effective Fed Funds rate. Rates in much of the developed world will likely not rise by much, if at all, this cycle. Thinking through where rates may go in the next recession is sobering and makes longer dated investment grade bonds attractive. This is something which the industry, with



**JENNA BARNARD – CO-FUND MANAGER OF HENDERSON DIVERSIFIED INCOME TRUST**

its short duration bias and constant misforecasting that government bond yields are set to move substantially higher, does not seem to agree with.

#### **SENSIBLE INCOME:**

*“In a country like England, where low rates of interest rule, a security offering 5 or 6 per cent would properly be looked at with suspicion.”*

*“Avoid bonds or shares to concerns which hold out a promise of an unusually high rate of interest, or an excessive profit.”*

In conclusion, this little book is a useful reminder of the importance of style and discipline in credit investment. It also emphasises that anchoring to the high interest rate and inflation regime of the 1980s when many started their career is neither useful nor rewarding as a mental starting point. Periods of low inflation, low interest rates and speculative manias are many and varied through history. Sensible bond investing can help investors navigate through these environments with capital intact.

So far in 2019 there’s not been a huge amount of change in the HDIV portfolio. It’s expensive to trade corporate bonds so any bond that makes it into the portfolio should adhere to our style of sensible income. The portfolio doesn’t have any cyclical exposure and we don’t buy debt from companies with huge operational leverage. We like dull, boring, reliable businesses albeit with a reasonable amount of debt. We get a decent coupon so there’s no need to trade small cyclical changes in the market.

It is fitting to end on some final wise counsel from the book. *“It is the common experience that fortunes tend steadily to increase in the ratio that losses are avoided.”*

#### **Notes**

The book mentioned in this article is: Anon (1892) ‘Counsel to Ladies and Easy-Going Men on their Business Investments and Cautions Against the Lures of Wily Financiers & Unprincipled Promoters’, London, The Leadenhall Press, Ltd: 50 Leadenhall Street, E.C. Effingham Wilson & Co., Royal Exchange. Simpkin, Marshall, Hamilton, Kent & Co., Ltd.

<sup>1</sup>Source: Bloomberg, Argentina 7 1/8 06/28/2117. Price correct at 1 May 2019.

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# Surf the ‘third wave’ of healthcare innovation with Syncona

Does the share price pullback present a buying opportunity?

**L**ife science focused investment trust **Syncona (SYNC)** generated an excellent net asset value (NAV) total return of 37.9% for the year to 31 March 2019, building on the previous year’s impressive 18.7% advance.

Following a share price drop from April’s 294p high point to 223p, this well-followed fund now trades at a more modest 4% premium to net asset value (NAV).

This could interest investors keen to back a FTSE 250 healthcare company with an impressive record of creating shareholder value and commercial therapies to boot.

Following its latest successful portfolio company sale, Syncona’s capital pool has risen to £963m. That accounts for around 72% of the current NAV, so investors are pricing in this ‘cash drag’ on performance and the fact drivers for its other unlisted, early stage investments over the coming 12 to 18 months are less visible.

And there are risks to weigh. Despite the share price decline year-to-date, Syncona still trades at an NAV premium, so investors are still having to pay over the odds to access the potential of the underlying portfolio.

New early stage investments will take time to deliver and asset

BIOTECHNOLOGY & HEALTHCARE TRUSTS			
Company	Share price	NAV	Discount/Premium
Syncona	223p	214.5p	4.0%
BB Healthcare	143p	140p	2.1%
International Biotechnology	670p	658.6p	1.7%
Worldwide Healthcare	£27.85	£27.83	0.1%
Biotech Growth	792p	868p	-8.8%
Polar Capital Global Healthcare	225p	247p	-8.9%

Source: The AIC- Data taken on 05/07/2019

write-downs cannot be ruled out given the risky industry in which the trust operates.

## SYNCONA 101

Formed in 2016 out of the merger between Battle Against Cancer Investment Trust (BACIT), a closed-ended fund of funds, and the life science investor Syncona Partners, Syncona focuses on investing in and

building global leaders in life science. Besides exciting, high quality investee companies, the portfolio consists of a large strategic capital pool of cash and fixed income products.

Under chief executive officer Martin Murphy, Syncona is differentiated from sector peers by being typically the founder and largest shareholder of its portfolio of assets, a risky



approach that has proved a successful formula to date.

Unlike peers, Syncona adopts a high conviction, preliminary stage investment strategy, and has the ability to take majority stakes and support portfolio companies.

The legacy BACIT/fund of funds portfolio is becoming history, yet it has left current day Syncona well endowed in terms of cash, so the trust hasn't needed to raise capital.

BACIT used to donate 1% of its NAV to cancer research charities each year, a philanthropic aspect of the trust which attracted investors and allowed it to access many funds at discounted terms.

That contribution continues with 0.3% of NAV, so Syncona retains a cancer cure angle, although it is now a riskier, albeit strongly performing, investment

**Syncona is an established leader in gene and cell therapy**

proposition than BACIT.

In its results statement covering the year to March, Syncona set aside £4.3m in donations to support charities in the field of healthcare, in particular cancer, taking total charitable donations since the company was established in 2012 to £27.1m.

### STRATEGIC DEEP DIVE

Syncona's stated vision is to 'deliver transformational treatments to patients in truly innovative areas of healthcare while generating superior returns for shareholders'.

Sector luminary Murphy and his team seek to partner with 'the best, brightest and most ambitious minds in science to build globally competitive businesses'. Syncona is an established leader in gene and cell therapy and focuses on delivering 'dramatic efficacy for patients in areas of high unmet need'.

The company has gone to the lengths of being the founding partner for its carefully handpicked early life science start-ups, helping build the companies and recruit their management teams together with leading academics.

A strong and extensive

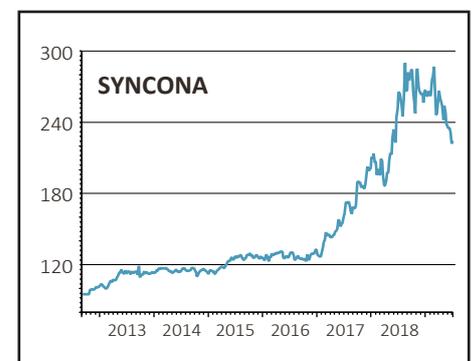
academic relationship includes links to University College London (UCL), the Institute of Cancer Research (ICR) and its connections with Wellcome Trust to access the best researchers, entrepreneurs and start-ups.

Wellcome previously backed Syncona Partners and remains the largest shareholder of the Syncona we know today with a 28% stake. In addition, Syncona proactively reaches out to leading scientists and supports them with funding and commercial expertise.

This higher reward approach comes with commensurate higher risk, because Syncona bears the majority of the funding burden for its focused portfolio and takes equally large exposure to the risks of failure.

This is much more risky than committing smaller amounts each to a highly diversified, relatively latter stage portfolio of assets that already boast clinical validation.

To date, Syncona has founded and funded Autolus, Nightstar, Blue Earth Diagnostics and Freeline in collaboration with leading academics and research institutes.



### HEALTHY RETURNS

Sparkling NAV gains since formation have been driven by the fruition of early investments

in Blue Earth Diagnostics as well as Autolus, a clinical-stage biopharma company developing Chimeric Antigen Receptor CAR-T therapies for haematological cancer and solid tumours.

This venture completed an IPO on NASDAQ in June 2018 and

Syncona retains a 30.4% stake.

Nightstar, a gene therapy company for inherited retina diseases that floated on NASDAQ in 2017, was recently acquired by Biogen for \$877m. That takeout price represents a 4.5 times return on Syncona's original investment and a 72%

internal rate of return (IRR), with the recently received proceeds of £255.8m further boosting the cash coffers.

## BLUE EARTH & THE NEW KIDS ON THE BLOCK

In its most recent positive development, Syncona announced the sale of Blue Earth Diagnostics to Italian-based diagnostic imaging leader Bracco Imaging for \$475m or £374m, out of which £337m will be distributed to Syncona for its 89% stake.

The sale delivered a 10 times multiple (including prior distributions) on Syncona's original £35.3m investment and represents an IRR of 87%.

Founded and funded by Syncona in 2014, the now profitable Blue Earth Diagnostics develops and commercialises molecular imaging agents with a commercially available product called Axumin, which is standard of care for the diagnosis of recurrent prostate cancer patients in the US.

These Blue Earth proceeds have strengthened Syncona's strategic capital pool and enhanced its ability to build and fund portfolio companies that are scaling rapidly.

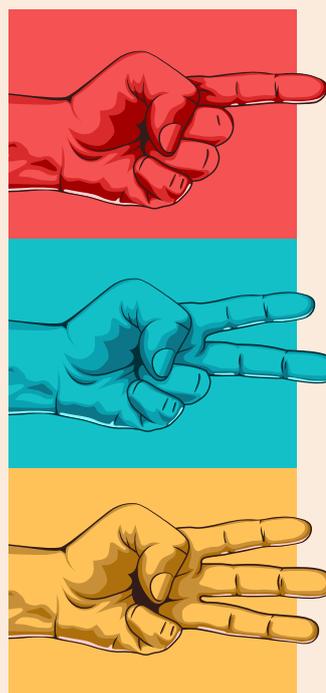
Syncona's new kids on the block include Freeline, a gene therapy company for chronic systemic diseases, as well as other earlier stage but promising businesses such as Gyroscope, Achilles, SwanBio, OMass, Anaveon and Quell.

## RIDING THE 'THIRD WAVE' OF INNOVATION

Subsequent to the large pharma dominated 'First Wave' of small molecule drugs in the 1950s and the 'Second Wave' of large molecules with antibody therapies and enzyme replacement therapies in the 1990s, Syncona believes the healthcare industry is entering into what it calls the 'Third Wave'.

This is defined as the emergence and increase in recognition of gene therapy, gene editing and genetically engineered cell therapy.

Syncona has a general focus and leadership position in gene and cell therapies. The trust has built a promising cell therapy portfolio with Autolus, Achilles, Quell and similarly a strong gene therapy portfolio with Freeline, Gyroscope and SwanBio.



### 'FIRST WAVE'

**1950s**

Small molecule drugs, market dominated by large pharmaceutical companies.

### 'SECOND WAVE'

**1990s**

Large molecule (antibody therapies and enzyme replacement therapies).

### 'THIRD WAVE'

**Today**

Advanced biologics and genetic medicines in areas such as gene therapy, cell therapy and DNA sequencing.



By James Crux  
Funds and Investment  
Trusts Editor

# The number cruncher



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# The fund with a disciplined approach to finding quality and value

Patience is key for JO Hambro Capital Management UK Opportunities Fund

**D**oes a fund with more than 25% of its holdings in cash tell you the managers are fearful? In the case of **JO Hambro Capital Management UK Opportunities Fund (B95HP81)** it is a mixture of the managers believing the market is over-valued and to also have the capacity to pounce on any sudden opportunities.

Many investors may come to the conclusion that such a large cash position would be a drag on performance. It's certainly true that this fund has lagged the rising market from time to time, such as underperforming its FTSE All-Share benchmark on a three and five-year basis.

However, the managers Rachel Reutter and Michael Ulrich have a laser-like focus on quality and their decisions could really shine when the market takes a turn for the worse.

Funds which have chased high-growth stocks on rich valuations are likely to plummet in a market downturn as stocks de-rate. In JOHCM UK Opportunities' case, its strategy of never overpaying for a stock would suggest it could thrive when the market rotates from a growth to value focus.

## SHOPPING TIME

When the UK market slumped in the fourth quarter of last year,



the managers were 'ready to go Christmas shopping'.

They added several new holdings to the fund including recruitment firm **Hays (HAS)**, specialty chemicals producer **Johnson Matthey (JMAT)**, and supermarket group **Tesco (TSCO)**. More recently they invested in retailer **Next (NXT)**. The fund is still left with 25.6% of its holdings in cash, as of 31 May this year.

Unless a business, and the management of the business, pass the fund managers' strict

quality criteria, there is no chance of it joining the 28 other stocks in the portfolio.

Even if it does meet the quality criteria, unless it offers both an attractive free cash flow yield and above-average liquidity in its shares it still won't make the grade.

## RULE #1: DON'T LOSE MONEY

It is this single-mindedness which has seen the fund achieve 8.3% annualised gains since it was launched in late 2005, with much lower drawdowns than the

market in 2008, 2011, 2015 and again late last year.

The managers' guiding principles are to preserve capital and to remain disciplined in pursuing growth at a reasonable price. This approach has led to a concentrated list of holdings with a large-cap bias and a greater than average liquidity, which should be a comfort to investors given the potential issues with holding less liquid assets.

The managers are also careful to avoid political risk and to shun companies which take on too much debt. When **British American Tobacco (BATS)** paid up to acquire US rival Reynolds in January 2017, and geared itself up in the process, the managers didn't hesitate to liquidate it.

'The decision to sell was simple,' says Reutter. 'The company over-paid and over-geared itself, so we sold it to zero'.

That decision saved the fund from suffering a 45% loss on British American Tobacco shares in the subsequent 12 months following the Reynolds deal but it also took cash levels above the 20% cut-off for the Investment Association's UK All-Companies sector meaning that the fund had to move into the Specialist sector.

JOHCM UK OPPORTUNITIES: HISTORICAL RETURNS					
	1yr	3yr	5yr	10yr	Annualised*
<b>A Acc GBP</b>	1.5%	17.0%	28.9%	174.6%	8.27%
<b>Benchmark</b>	-3.5%	27.8%	28.9%	147.4%	6.40%

Benchmark is FTSE All-Share TR. \*Since launch Nov 2005

Source: JOHCM, as at 31 May 2019

### LONG TERM THEMES

The managers typically have a 10-year investment horizon when they buy a stock. As well as fitting the quality and liquidity criteria they look for long-term drivers behind the businesses.

For example Hays is a play on the long-term trend towards rising wages in major economies as the global pool of labour shrinks due to demographics. Crucially, for a business which is still cyclical in the short term, Hays has no debt.

And as for Johnson Matthey in the portfolio it has accelerated investment in cathode technology in order to benefit from the long-term trend towards pollution control and electric vehicles.

### STRICT SELL DISCIPLINE

As the market rallied sharply in the first quarter of this year the managers took the opportunity to sell out of **Howden Joinery**

**(HWDN), Land Securities (LAND) and National Grid (NG.)** completely.

After a 25% rise in its share price, Howden no longer looked good value and the team's sell discipline kicked in. Several other stocks were reduced, including **Compass (CPG), Diageo (DGE) and GlaxoSmithKline (GSK)** after their share prices outperformed on what the team deemed to be positive sentiment rather than fundamental factors.

The decision to sell National Grid was due to two factors: a shift in the political environment, with direct threats from the Labour party of nationalisation, and tougher regulation by the current Government.

Like banks, which the fund avoids due to their cyclicity and indebtedness, utilities are now avoided in the portfolio due to political risk despite their obvious ability to generate lots of cash.

## THE RIGHT QUALITIES

THE TEAM AIMS to hold a mix of companies which are well-diversified both geographically and in terms of their businesses.

Companies should be self-funding, i.e. debt-free, with reliable revenue growth driven in part by

long-term themes and in part by barriers to entry into their business which limits new entrants and keeps margins healthy. These companies typically generate high free cash flows which can then be reinvested in the business.

### SHARES SAYS: ↗

We really admire the fund's investment process and strict discipline for buying and selling. This would be a great addition to a diversified portfolio. Buy now.



By Ian Conway  
Senior Reporter

# Inheritance tax system could see major overhaul

Gift-giving rules could improve but capital gains tax could make life more complicated



A Government adviser says the gifting allowance should go up

**I**nheritance tax is the UK's most hated tax and it's also one of the most complicated systems. A new report is aiming to change at least the second of these two realities.

The Office of Tax Simplification (OTS) was tasked with digging into the current system and working out how to make it simpler and easier for people to understand. It comes after recent HMRC research found that just 45% of people gifting money knew how inheritance tax rules worked, highlighting the need for both simplified rules and more education.

The OTS has [released the second](#) of two reports on the topic, suggesting changes from the way gifting works to raising the issue of the complicated newest tax break, the residence nil rate band. [Its first report](#) looked more at the system of

applying for and processing IHT.

So what could be changing in the future?

## CHANGING HOW GIFTING WORKS

Currently there is a messy system for how much money you can gift each year before it's counted as part of your estate for inheritance tax purposes.

[Everyone can give away up to £3,000 a year](#), whether in one gift or multiple gifts equalling this amount. There are extra breaks for gifting when someone gets married or enters a civil partnership and you can also gift money out of your 'normal income'. These allowances have been the same for years and haven't kept pace with inflation.

The OTS report suggests cutting all these different allowances and just giving everyone one higher allowance

each year that they can gift. It also suggests removing the ability to gift money from disposable income. This part of the gifting rules is little understood and there have never been clear guidelines on exactly how much you can gift, but removing it entirely would take away a very lucrative tax break.

## DITCHING THE TAPER

The seven-year taper is another complicated area of the inheritance tax system. It means that if you gift more money than is allowed by the above gifts, and when you die your estate is liable for inheritance tax, any gifts made in the past seven years could be subject to inheritance tax. The taper part of this rule is because the amount of tax due reduces each year, until none is due when you reach the seven-year point – see the table below.



Years between gift and death	Tax paid
Less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
7 or more	0%

Source: HMRC



The new residence nil rate band is so fiendishly tricky that the OTS said some professionals refuse to advise on it

The OTS said that the rule 'requires a large amount of record keeping but raises little tax' and that it's 'widely misunderstood'.

Instead it suggests cutting the seven year limit down to five years, but crucially, scrapping the taper altogether. This means that if someone gifted money and died within five years the full 40% inheritance tax would be due on the money. The move would create a cliff-edge, whereby if someone died four years and 364 days after giving a gift then tax would be due, but if they died a day later the entire gift would be tax free.

### RESIDENCE NIL RATE BAND

The new [residence nil rate band](#), introduced in 2017, ultimately means that each couple can leave a £1m property in their estate with no inheritance tax to pay. However, it's so fiendishly tricky that the OTS said some professionals refuse to advise on it.

The rules have been branded as unfair, as the tax break only

applies if you leave your main property to your children, grandchildren or step-children and step-grandchildren. The OTS acknowledged that this is unfair for those with no children or those who live with siblings and want to pass their house onto them.

However, it didn't suggest an easy solution. It said that scrapping the relief entirely would lead to a 68% increase in the number of estates paying IHT by 2023-24, while scrapping it and raising the normal nil rate band to £500,000 would cost the Government an extra £7.5bn during that time – neither feels like a workable option.

Instead it deferred a decision until the relief had been in place longer and the Government could assess how well it's working.

### CHANGES TO CAPITAL GAINS TAX

Currently if anyone leaves you money or assets when they die, generally there is no capital gains tax due. If you subsequently sell

on that asset you just pay CGT on the increase in its value since you inherited it – so if you sell it on immediately none is due.

The OTS argues that this makes people less likely to gift assets during their lifetime, as they would have to pay the CGT due on it. So instead it recommends scrapping this tax benefit.

It would mean that if you inherited an asset and then sold it on you would pay capital gains tax on the difference between what it was worth now and what the person gifting it to you had originally paid for it.

### HOW DO PENSIONS FIT IN?

The rules around whether pensions are subject to inheritance tax aren't clear cut. Currently HMRC rules force most providers to exercise discretion over how pension death benefits are paid out. This is because where discretion is not used, or a pension is transferred or contributions increased while someone is in serious ill-health, the money left behind is subject to IHT.

However, the process of exercising discretion can mean significant delays and extra costs. The OTS report acknowledged this issue, but didn't offer a solution. Instead it called for a wider review: 'It may be appropriate, at some point in the future for the government to consider a wider review of the tax system and pensions, possibly carried out by the OTS.'



By **Laura Suter**  
AJ Bell Personal  
Finance Analyst

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Investment Ideas

# When will I receive the state pension?

We explain the rules and where everyone can go to check their state pension age

*I celebrated my 61st birthday in June and I'm starting to think about when I'll retire. I've got my private pensions sorted but I'm struggling to figure out when I'll get my state pension.*

*Is there a chance the date will change? The thought of a moving target is pretty unnerving. Any help you can provide would be greatly appreciated.*

**Moira**



**Tom Selby**  
AJ Bell  
Senior Analyst says:

The state pension is the foundation upon which you can build your retirement plan.

While for most people it isn't enough to fund their standard of living when they stop working, the guaranteed income stream it provides is a useful starting point.

The new flat-rate state pension pays a maximum of £168.60 a week, although those who built up rights under the pre-2016 system or have gaps in their National Insurance record could get more or less.

It is also currently protected by the so-called 'triple-lock', meaning it rises each year in line with the highest of average earnings, CPI inflation or 2.5%.

Aside from the amount you receive from the state, the other key element is the age at which you receive it. This remained unchanged between the end of



the Second World War and 2010, with women entitled to the state pension at 60 and men at 65.

The 1995 Pensions Act set in train equalisation of women's and men's state pension ages at age 65 between 2010 and 2020. This timetable was controversially accelerated by the 2011 Pensions Act, bringing forward the equalisation date to 2018 followed by two years of phased increases to age 66 by 2020.

The subsequent 2014 Pensions Act took this a step further, creating legislation to increase the state pension age to 67 by 2028. The state pension age is due to increase again to age 68 by 2039. Each of these rises will be phased in over a two-

year period.

Under the existing timetable you should therefore receive your state pension from your 66th birthday onwards in 2024.

And while the state pension, like most other things, is subject to the whims of politicians, the Government has said any further increases in the state pension age will give people at least 10 years' notice.

This commitment is designed to give people confidence the goalposts won't be constantly shifted as they plan their retirement.

For readers who want to check their state pension age, the Department for Work and Pensions has a handy calculator [here](#).

## DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to [editorial@sharesmagazine.co.uk](mailto:editorial@sharesmagazine.co.uk) with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

Please note, we only provide guidance and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

## HOW I INVEST:

# The 'millennial money therapist' helping younger people

Josette started investing at 18 and now she wants her friends to get on board



**I**t is always pleasing to come across young people interested in the world of investing. Building up a healthy savings habit early in life can reap significant benefits later on, and having the right attitude from the start can make a big difference between knowing you need to save and actually doing it.

Josette, a 25-year-old from Kent, is intent on building up her wealth and helping others in the process.

She's called a 'millennial money therapist' by her friends after empowering them with financial wisdom. 'There is a huge push for younger people to start talking more about their finances and most of my friends don't feel confident about saving, let alone investing – but there is a definitely a shift in the way people are thinking,' she says.

Her money-making journey began aged three when she charged family members 5p each to watch a magic show. On her eighteenth birthday, Josette's parents helped her to open an ISA with a £5,000 gift that was put into an investment fund. She took the next step at age 21 by buying her first share, which was fashion group **Burberry (BRBY)**.

'I was talking to a friend who'd been investing for a while and he suggested that I invest a small amount into a company which I would actually like to follow. That helped me learn the ropes and start to become familiar with the jargon that comes with investing,' says Josette. 'It was only an £80 investment but I ended up making a £28 profit when I sold.'

## A MONEY MAESTRO

The money maestro has slowly built up knowledge about investing and personal finance through her job for a financial services company.

She admits to being a big spender but is rigorous about putting a certain amount of cash each month into her investment accounts, spread across a Stocks and Shares ISA, a Lifetime ISA and a SIPP (self-invested personal pension).

The latter two both hold investments in **Fundsmith Equity (B41YBW7)** which is Josette's best performing holding. 'This was my original SIPP investment which I've contributed to each month. I was looking for a stable core investment to build my portfolio

around; so far it has been terrific,' she says.

**FOCUS ON SUSTAINABILITY**

Having grown up on a farm and more recently moved to the bright lights of London, Josette explains that she has started to align her investments with her personal beliefs.

She is investing in more sustainable and ethical investments such as **Stewart Investors Worldwide Sustainability Fund (B7W3061)**, which is her second best portfolio performer.

This investment fund invests in companies which should benefit from, or contribute to, the sustainable development of the countries in which they operate. Names in its portfolio include consumer goods giant **Unilever (ULVR)** and US healthcare IT company Cerner.

More recently she added money to **Lyxor Global Gender Equality ETF (GEND)**, an exchange-traded fund which tracks an index of 150 companies around the world that score highly for gender equality. The index includes beauty company Avon Products, chocolate maker Hershey and Spanish utility group Iberdrola.

Once a month Josette and her friends plan a themed evening where one of them educates the others about a certain topic, typically linked to their jobs. Perhaps unsurprisingly, her turn was about how ISAs and SIPPs worked.

'We like to share information about something we feel is important. One of my friends is training to be a doctor so they taught us a few useful medical things. Another is an office manager who gave us a lesson on first aid. And I talked to them about saving and investing as they all said they lacked confidence and knowledge about this subject matter.'

**FIGHTING AGAINST A KNOWLEDGE BLOCK**

Josette says she is the only person in her social group who has started to invest, although there is interest among her friends despite them being nervous. They're taking one step at a time by opening cash savings accounts.

'In my social circle there is absolutely a knowledge block about investing. My friends can handle the pressure of hospital wards as junior doctors and teach a classroom of five-year-



olds, but as soon as you mention investing and pensions they shrink back into their seats,' she reveals.

'Unless they learn about it, investing is definitely something they'd either leave to their dads or other halves – I even manage my boyfriend's Lifetime ISA and Stocks and Shares ISA.'



By Daniel Coatsworth  
Editor

**WOULD YOU LIKE TO FEATURE AS A CASE STUDY IN SHARES?**

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Please note, we do not provide financial advice and we are unable to comment on the suitability of any investments you have made. If you're unsure please consult a suitably qualified financial adviser.

# Why Wizz Air wants to lower fares but increase extras

The airline is on a relentless pursuit of growth and has its rivals in its sights

**H**e made his name as the man who brought Pringles to Hungary.

Now **Wizz Air (WIZZ)** co-founder and chief executive Jozsef Varadi is once again trying to create waves in Eastern Europe.

The Budapest-based airline has expanded significantly as passengers across the region take advantage of the cheaper cost of travelling, and its boss is on a mission to carry on making air fares lower.

## FOCUS ON LOWERING FARES

'I am invested in lowering fares. It enables us to stimulate the marketplace and get more people interested in flying,' Varadi tells *Shares*.

For Wizz Air, lowering fares makes sound business sense given that unlike its more Western Europe-focused rivals, **Ryanair (RYA)** and **EasyJet (EZJ)**, its main customer base is from Central and Eastern Europe.

Incomes are growing fast in the region, and more people than ever in these countries are wanting to travel and see more



of the continent.

But salaries are still not up to the levels of Western Europeans, so the lower the fares the more people who can travel.

And once these people get richer, the more they can then spend on other services with Wizz Air.

'Central and Eastern Europe is a market that continues to grow twice as much as Western Europe in terms of GDP. So that creates more income as people in the region get richer, and we benefit from that,' Varadi explains.

The company recently opened in new markets such as Georgia, Israel and Ukraine. It doesn't yet have the scale of Ryanair or EasyJet, but is growing faster than its competitors, something which is reflected in the divergent tale of their respective share prices.

While it encountered turbulence earlier this year, at £36.04 Wizz Air's share price

is marginally ahead of where it was a year ago. Ryanair on the other hand has seen its share price drop by a third, and EasyJet by around 40%.

Wizz Air's full-year results to 31 March this year were generally ahead of forecast, with a 6% increase in profit to €291.6m and a 19.6% rise in revenue to €2.3bn.

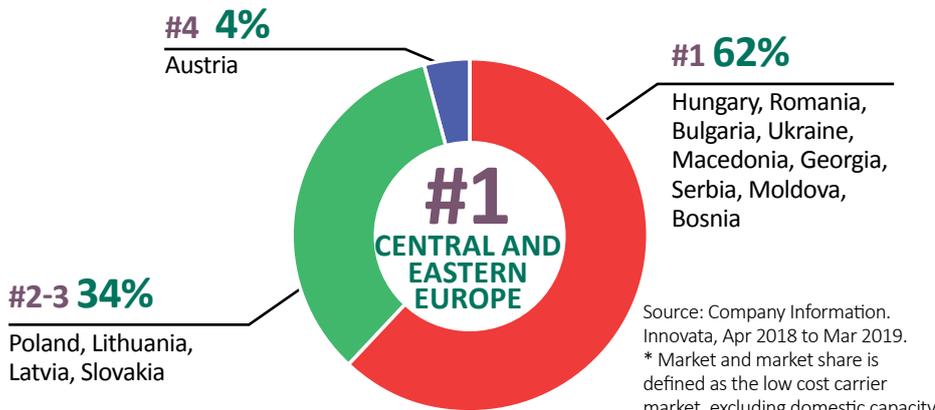
Ryanair saw profit fall 29% to €1.02bn in its full-year results, which it blamed on lower fares, on revenue of €7.56bn, while in its last full-year results to 30 September 2018, EasyJet recorded a 13% rise in pre-tax profit to £578m, on revenue of £5.9bn.

## ANCILLARY REVENUE IS KEY

A key part of Wizz Air's business strategy is driving ancillary revenue. While this part of the company's income has drawn praise from shareholders and some of the wider market, it has drawn anger from consumer champions.

Wizz Air has reduced carry-on

## WIZZ AIR: MARKET POSITIONS



luggage to just one handbag-sized item, something which has left many passengers in for a nasty shock at the airport.

Airlines such as Wizz Air say this is to speed up boarding, but critics suspect it's just another ploy to increase revenue.

Regardless, from a business perspective the reasons why Wizz Air and its boss are so focused on ancillary revenue are clear.

After all, ticket prices typically fluctuate depending on market response, whereas the price of the other services the airline provides remains relatively stable.

The more money it can bring in through checked bags, individual seat assignments, hotel commissions, etc, the less

it will be impacted by issues such as higher fuel prices, which has caused issues for a lot of airlines.

### RISING ABOVE THE COMPETITION

Varadi says Wizz Air makes more ancillary revenue than any other airline in the world – 43% of its total revenue versus 26% from Ryanair and 19.5% from EasyJet.

Ryanair has a stated aim to get 30% of its money from ancillary revenue by 2020, while EasyJet hasn't set a target.

The aim, Varadi states, is for Wizz Air to 'cross the 50% line'. 'Ancillary revenues have been a big focus for us. They tend to be more stable,' he says.

The risk is that this status

alienates prospective fliers and undermines the company's strong competitive position.

### NEW AIRCRAFT INCOMING

What also marks out Wizz Air from its competitors, at least in Varadi's view, is the new aircraft – the Airbus A321neo – it has ordered.

Having picked out Ryanair as his main rival, the Wizz Air boss sees the A321neo as the reason why the airline can get its unit cost below that of its Irish counterpart.

The Wizz Air boss believes the higher number of seats the airline can cram into the A321neo, plus its better fuel efficiency, means his company will be able to get its unit costs below that of its peer.

He says: 'These savings enable us to offset cost issues like volatile fares, labour cost pressures and rises in the fuel price. I don't think [other airlines] have those levers to be able to stabilise costs.'

### SHARES SAYS:

**Wizz Air is an attractive business and investment bank Berenberg notes that it generates a higher return on capital than Ryanair (16% versus c9%, respectively) and has better long-term growth prospects.**

**However, airlines can be volatile investments and they operate in a highly competitive market. The trick is to buy the shares when sentiment is very weak towards the sector and the share prices have been beaten up.**



The leading budget airline in Central and Eastern Europe, Wizz Air has upwards of 100 aircraft and operates out of 25 airports.

The company has a particularly young fleet of aircraft which has benefits in terms of reliability and fuel efficiency.



By Yoosof Farah  
Reporter

# Franchise firms can earn you tasty capital gains and juicy income

We look at the business models of Cake Box, Domino's Pizza, Filta and Franchise Brands

**C**ompanies with franchise business models have often been very good investments over the years. Many have been able to pay generous dividends as well as deliver capital growth for shareholders.

Well-run franchises provide investors with defensive characteristics as well as growth opportunities, and therefore can be a valuable addition to a balanced investment portfolio.

Franchise models can take various forms, but what connects them all is their 'capital light' characteristics. That is to say, each franchisee is expected to provide the capital investment and manage the operations in return for the legal right to use a brand or business process.

The main advantage of such an arrangement is that the master franchise owner can expand quickly and without the need to raise equity or bank debt in order to facilitate growth. It is therefore comes with lower financial risk.

## HOW DO THEY EARN MONEY?

There are multiple revenue streams available for the franchisor, including royalties for using a brand, a share of revenues, fees for providing training, supplying products on long term contracts and fees for



arranging financing.

In return for taking risk, franchisees have an opportunity to become their own boss, run a business and potentially own multiple franchises, enriching themselves in the process.

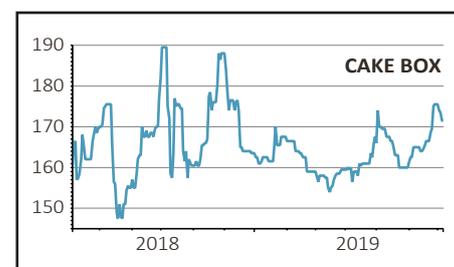
The opportunity has to first demonstrate clear business merit, with potential for good returns and growth, in order to attract talented entrepreneurs.

## BRANDED FRANCHISE MODELS

**Cake Box (CBOX:AIM)** is a good example of a branded franchise model. It listed on the stock market a year ago and sells egg-free freshly made cakes which are sponge-based and use fresh cream.

Sukh Chamdal and Pardip Dass co-founded the Cake Box franchise business in 2008, addressing an underserved

market of people who either had an egg allergy or observed a lacto-vegetarian diet.



As Cake Box has grown, its products have increasingly appealed to a broader customer base who purchase the group's cakes despite not requiring egg-free products, thus reducing the company's reliance on a narrower demographic.

The company has grown predominantly through franchise expansion and does not directly own or operate any Cake Box stores. Today it has 113 outlets and is on course to open around 24 new stores every year. The

target is 250 sites in the UK.

The appeal of the stores has been so strong that Cake Box receives over 100 applications every month. These prospects are whittled down to two per month, on average.

Each applicant is responsible for identifying an appropriate site, which is then reviewed by the company for its feasibility. Once approved, the franchisee is required to invest £125,000 to open a store.

A minimum equity contribution of £35,000 (including the deposit) is required, and the rest is usually funded by bank debt.

The company has banking arrangements in place to offer its franchisees, subject to credit approval. Cake Box is not responsible for paying off the debt.

A lease and franchise agreement are signed (usually for a five-year term) under which the company has a right to terminate the agreement at any time if the franchisee commits any infractions of the rules.

The franchisees are required to purchase all of their ingredients through Cake Box, no substitutions or unauthorised products are allowed.

### WHAT'S IN IT FOR FRANCHISEES?

Cake Box has developed an attractive proposition offering a simple and affordable package for new store owners. The hours are reasonably sociable, from 11am to 7pm and 99% of stores are profitable.

The company doesn't charge any ongoing management fees or marketing levies, unlike many



other franchise operators. The brand and distinctive proposition provides the franchisees with the opportunity to grow revenues and on average the stores have seen double-digit like-for-like annual revenue growth.

On average, a store that has been open for at least 12 months will generate £94,000 earnings before interest, tax, depreciation and amortisation (EBITDA) a year. A store has an average payback of 18 months.

This is a very attractive return on investment giving the more enterprising franchisees an opportunity to own multiple outlets. Currently over 20 managers own multiple stores.

### HIGH RETURNS ON CAPITAL FOR THE FRANCHISOR

The franchise model has allowed Cake Box to grow its stores rapidly, grabbing market share in a very short space of time, without incurring the financing costs and associated credit risks.

The returns on capital and cash generation are very attractive. For example, Cake Box converts all of its net profits into cash, and generates a very attractive 45%

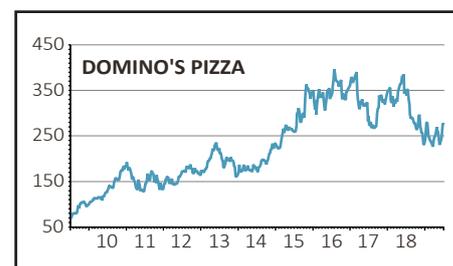
return on equity.

Cake Box is arguably still in the early stages of its expansion phase. It floated on the stock market at 108p in June 2018 and its shares now trade at 171.5p, equal to a 59% capital gain in just over a year. It has also paid out 2.4p in dividends.

### OTHER FRANCHISED BUSINESSES IN THE UK MARKET

The best-known franchise company on the UK stock market is **Domino's Pizza (DOM)** which holds the master franchise rights for the brand in the UK, Ireland, Switzerland, Liechtenstein and Luxembourg.

It makes money by selling its franchisees ingredients and fresh dough bread as well as charging royalties. It passes on some of the royalty payments to the ultimate owner, Domino's Pizza International Franchising.



Investors had enjoyed decent gains for a long time until a few years ago. Its international operations have been struggling to deliver the expected levels of growth and UK franchisees have become troublesome for the company by lobbying for a greater share of profits.

This goes to show that franchise companies are not a guaranteed way to make money from investing.

Among the small caps, **Filta (FLTA:AIM)** offers its franchisees proprietary mobile cooking filtration units (MFUs), with specially designed filters for the sole use with the MFU's.

The growth in the trend of eating out has led to an increasing number of professional kitchens. These have become subject to more stringent regulations due to the environmental impact of disposing of used oil.



Filtering can double the life of cooking oil, thus lowering costs, while also saving time

and removing a potentially dangerous job for the staff. Filta isn't a pure franchised business as it runs a few other businesses directly.

## PORTFOLIO OF FRANCHISES

One of the downsides for investors in franchised businesses is that they are locked into one product, or brand, so have concentration risk. One alternative is to consider investing in a company which has multiple franchises.

A relevant example is **Franchise Brands (FRAN:AIM)**, run by Stephen Hemsley who is considered to be one of the UK's experts on franchise businesses.

The company earns fees though start-up charges, license fees and product sales. Its franchise portfolio includes car repair firm ChipsAway and Metro Rod, which provides drains clearing and maintenance services across the UK.

## PREMIUM PRICE FOR FRANCHISE STOCKS

Franchise companies often trade on high equity valuations. This is partially to reflect their capital-light model and the fact that most are highly cash-generative businesses. Investors are happy to pay a premium price to access the potential capital gains and hopefully generous dividends over time.

The accompanying table illustrates the range of price-to-earnings ratios for UK-quoted franchise stocks.

COMPARISON OF FRANCHISE COMPANY PE RATIOS	
Company	Forward PE*
Franchise Brands	21.8
Filta	18.2
Cake Box	17.0
Domino's Pizza	16.7

\*Based on latest share price and earnings forecasts for current financial year

Source: Source: Shares, Reuters, Shore Capital



By **Martin Gamble**  
Senior Reporter

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## KEY

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

Anglo American (AAL)	8
Balfour Beatty (BBY)	16
BHP (BHP)	8
Bigblu	13
Broadband (BBB:AIM)	
Bovis Homes (BVS)	9
British American Tobacco (BATS)	33
BT (BT.A)	20
Burberry (BRBY)	38
Cake Box (CBOX:AIM)	42



Compass (CPG)	33
Costain (COST)	15
CRH (CRH)	16
Diageo (DGE)	33
Domino's Pizza (DOM)	43



EasyJet (EZJ)	40
Energie Oil & Gas (ENOG)	9
Fevertree	2
Drinks (FEVR:AIM)	



Filta (FLTA:AIM)	44
Franchise Brands (FRAN:AIM)	44
Fundsmith Equity (B41YBW7)	38
Galliford Try (GFRD)	16
GlaxoSmithKline (GSK)	33
Halfords (HFD)	12



Hays (HAS)	32
Hill & Smith (HILS)	16
Howden Joinery (HWDN)	33
Ibstock (IBST)	16
Imperial Brands (IMB)	9

James Halstead (JHD:AIM)	2
JO Hambro Capital Management UK Opportunities Fund (B95HP81)	32

Johnson Matthey (JMAT)	32
Kier (KIE)	15
Land Securities (LAND)	33

Lyxor Global Gender Equity ETF (GEND)	39
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Marshalls (MSLH)	16
National Grid (NG.)	33
Next (NXT)	32

Pershing Square (PSH)	14
Persimmon (PSN)	9

Polar Capital Technology Trust (PCT)	10
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Polypipe (PLP)	16
Rio Tinto (RIO)	8

Ryanair (RYA)	40
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Scottish Mortgage (SMT)	13
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SIG (SHI)	15
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Stewart Investors Worldwide Sustainability Fund (B7W3061)	39
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Syncona (SYNC)	28
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Telecom Plus (TEP)	14
Tesco (TSCO)	32
Unilever (ULVR)	39
Whitbread (WTB)	7
Wincanton (WIN)	12
Wizz Air (WIZZ)	40



## KEY ANNOUNCEMENTS OVER THE NEXT WEEK

### Full year results

**12 July:** Urban Logistics REIT. **15 July:** City of London, Polar Capital Technology Trust. **16 July:** Gateley. **17 July:** Watches of Switzerland. **18 July:** Sports Direct.

### Half year results

**18 July:** Audioboom, Eve Sleep, Moneysupermarket.com.

### Trading statements

**15 July:** Rio Tinto. **16 July:** BHP, Burberry, Hays. **17 July:** Euromoney Institutional Investor, Galliford Try, Headlam, Premier Oil, Severn Trent, TalkTalk. **18 July:** AO World, EasyJet, SSE, Thomas Cook.

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