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# Takeovers aren't always welcome

Bidders, get your hands off our prized investments

**T**akeovers and mergers are dominating the headlines as companies make acquisitions to accelerate growth, foreign companies take advantage of a weak pound to buy UK businesses, and private equity firms put some of their spare cash to use.

While this M&A frenzy has recently triggered some hefty share price movements, such as **Just Eat (JE.)** rising by 25% on a merger deal with Takeaway.com and **Cobham (COB)** jumping nearly 40% on a bid from Advent, there are often downsides to such corporate activity.

Let's say one of the stocks in your portfolio is taken over and delists from the market. You may get a 20% to 30% premium to the market price before the news was announced, but you could suffer from losing an investment which could generate significant returns for years to come.

Long-term investors could argue that the typical 20% to 30% bid premium woefully undersells the target company's true value generation potential.

For example, three years ago FTSE 100 technology giant ARM Holdings was bought by Softbank. The takeover was arguably bad news for investors who had enjoyed average annualised shareholder returns of more than 30% over the previous decade from the stock.

Imagine one of your greatest investments disappearing from your portfolio. You might get a chunk of cash as compensation yet finding a suitable replacement is likely to be a hard job, particularly as most quality companies are currently trading on high valuations.

So the next time one of your portfolio holdings receives a bid, take some time to think about

the longer-term impact on your wealth and also whether you will receive cash or shares from the bidder.

Some bids are made by foreign companies and the deals are structured as cash, a mixture of cash and shares, or just shares. Therefore you could potentially end up owning stock in an overseas-listed company, which is something some UK investors don't want.

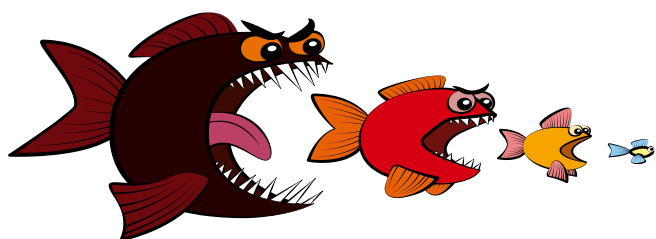
However, a takeover can occasionally provide some relief, particularly if a share price has been struggling. For example, **Merlin Entertainments (MERL)** floated at 315p in November 2013 and exceeded 500p in summer 2017.

Subsequent share price weakness wiped out all these gains until a takeover bid emerged just over a month ago at 455p. Assuming the deal completes, the price means investors may narrow their losses or some might walk away with a profit.

Private equity firms have struck £13.6bn worth of UK deals so far this year, according to Dealogic, the highest level since 2007. The industry is awash with cash after making substantial disposals in recent years so private equity firms are looking to recycle the proceeds by doing new deals.

Should one of your investments be taken over by private equity there is a chance it could reappear on the stock market in the next few years, as holding periods by such acquirers can be short. However, the key question is whether your prized company is still in the same state as when it left your portfolio as private equity firms have a habit of draining cash out of a business and loading it with debt.

Takeovers can be exciting on the initial news but they aren't always good for your long-term wealth creation.



By Daniel Coatsworth Editor

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# No joy for investors stuck in suspended Woodford fund

But manager Neil Woodford could be sacked from running the Patient Capital Trust

**I**nvestors in **LF Woodford Equity Income Fund (BLRZQ62)** will have to wait until at least December before they can access their money.

Buying and selling in the fund has been suspended since 3 June and will stay that way until later this year while fund manager Neil Woodford restructures the portfolio to focus mainly on large and mid-cap stocks in the FTSE 100 and FTSE 250 indices.

Analysis of company disclosures to the stock market shows that in July he has been selling down positions in doorstep lender **Provident Financial (PFG)** and subprime lender **Non-Standard Finance (NSF)**, as well as activist fund **Crystal Amber (CRS:AIM)**, Southend Airport owner **Stobart Group (STOB)** and transport play **Eddie Stobart Logistics (ESL:AIM)**.

Under-fire Woodford has also been selling down positions over the past month in **NewRiver REIT (NRR)**, **IP Group (IPO)**, **Allied Minds (ALM)** and memory foam mattress seller **Eve Sleep (EVE:AIM)**.

Woodford says 80% of the proceeds from share sales since the suspension in June have been reinvested in FTSE 100 companies.

His asset management business is under increasing pressure from investors to reduce fees during the suspension period.

Meanwhile, the fund manager has sold approximately £1m of his personal holding in **Woodford Patient Capital Trust (WPCT)**, another fund he runs. Woodford said he was a 'reluctant seller' after disposing of 1.75m shares or around 60% of his holding to meet 'personal financial obligations, including a tax liability'.

The board of Woodford Patient Capital Trust on 29 July revealed that it had been talking with



Neil Woodford, Fund manager

The fund manager sold **£1m** of his own shares in July

various third party management groups, indicating that Neil Woodford could be sacked as manager. Shares in the investment trust have halved in value since it floated on the stock market in 2015.

'We think any new manager taking on the contract should make some assessment via the board and shareholders as to whether this would be on a normal long-term continuing basis, or whether shareholders will look for the investment trust to go into "run-off" with disposals of investments and returns of capital to investors,' say analysts at investment bank Stifel.

Woodford Patient Capital Trust has a three month notice period to change manager, shorter than the normal six to 12 month period. Stifel believes any change in manager would result in a different fee structure, scrapping the current arrangement for no annual management fee and Woodford only being remunerated through a performance fee.

'Whilst Woodford IM is not receiving any annual fee income for managing the investment trust under the current fee structure, we think that if the contract was removed, it could be a symbolic blow to Woodford Investment Management,' adds Stifel.

# Vodafone shares see largest ever one-day jump

Spinning off its towers business could prompt investors to reappraise the stock

Investors in mobile network operator **Vodafone (VOD)** received some rare good news last week, sending the shares up over 10% on Friday (26 Jul) and another 6% on Monday (29 Jul) to 154p, their best level in more than six months.

Chief executive Nick Read, who has been in the job less than a year, has proposed hiving off Vodafone's European mobile towers interests into a separate legal entity called 'TowerCo' and possibly listing it on the London stock market within the next 18 months.

Phone masts are hardly glamorous but they generate significant cash flows and while listing them on the stock market may sound novel, tower companies have been popular with European and US investors for many years.

A flotation of TowerCo could not only be used to pay down some of Vodafone's sizeable debt but valuations of European and US peers suggest that it could transform the company's own market value.

Spain's Cellnex Telecom, which gets two thirds of its revenue from renting its 45,000 towers to mobile phone networks, has an enterprise value (EV), or market capitalisation plus debt, of €14.1bn.

Analysts forecast Cellnex's earnings before interest, tax, depreciation and amortisation (EBITDA) will reach €640m this year, which means investors are paying a multiple of 22 times EV-to-EBITDA in order to own the shares.

Vodafone's TowerCo owns Europe's largest portfolio of 61,700 towers across 10 markets and according to Read is capable of generating 'potential' proportionate EBITDA of €900m per year.

Putting a multiple of 22-times on TowerCo's EBITDA would value the towers business alone at almost €20bn or £18bn against Vodafone's market value of £35bn and EV of £68bn the day before the announcement.

Vodafone also announced last Friday that it had agreed to merge its Italian tower infrastructure



“**VODAFONE'S TOWERCO OWNS EUROPE'S LARGEST PORTFOLIO OF 61,700 TOWERS ACROSS 10 MARKETS**”

with Telecom Italia in a deal which values the unit at an EV-to-EBITDA multiple of 24-times.

Finally, Crown Castle International, which owns a portfolio of US mobile phone towers, is valued at 22 times EV-to-EBITDA so a valuation of between 20 and 25-times for TowerCo would seem reasonable.

If Read can hive off the towers business with a big chunk of debt – its listed peers carry debt equivalent to between 40% and 75% of their market value – it could go some way to reducing Vodafone's parent company indebtedness.

We should stress that none of the above is set in stone other than the plan to separate the towers unit. More detail will doubtless emerge at the analyst meeting on 19 August.

# Just Eat shareholders should hold out for a better offer

Takeaway.com's merger price looks too low and others may also be interested

**N**ews of a proposed merger between fast food delivery group **Just Eat (JE.)** and Dutch based competitor Takeaway.com saw the former's shares trade at a 9% premium to the 731p offer price. This implies the market is confident of a counter bid from someone else.

The merger proposal shouldn't come as a surprise because activist investor Cat Rock Capital, which has stakes in both businesses, cited a 'clear rationale' for the merger in an open letter to management on 11 February.

A lot of investors have shorted Just Eat's shares, meaning they would profit from a decline in the share price. Closing the short positions will put extra upward pressure on the shares. Roughly 50m shares or 7.34% of the stock are held short, up from 4% since the start of the year, according to shorttracker.com.

Secondly, the deal may flush out a higher, competing offer for the company. Originally a pure-play high margin takeaway platform, focusing on restaurants that do their own delivery, Just Eat has struggled to execute on its plans to build its own delivery system.

Cat Rock was critical of the board's appointment of previous chief executive Peter Plumb, who it

claimed to lack online food delivery experience. South African group Naspers has been investing in food delivery and has a 22.5%

stake in German company Delivery Hero, while Uber and Deliveroo have entered the UK food delivery market, putting pressure on Just Eat's market position.

Analysts at Liberum believe the regulator might allow an Amazon/Just Eat tie-up in preference to current plans for Amazon to invest in Deliveroo.

The third reason is related to the current deal's metrics. Following completion, Just Eat shareholders will own 52.2% and Takeaway.com 47.8% of the combined share capital.

Just Eat has a business which is three times larger than its acquirer and made £82.7m of profit last year while Takeaway.com is still loss-making.

However the combined company will be run by Takeaway.com management, and will be incorporated, headquartered and domiciled in Amsterdam, albeit with a listing on the London Stock Exchange.

The implied enterprise value-to-sales at five-times is roughly half the multiple that Takeaway.com paid for the German business of Delivery Hero last year.

This may prompt Just Eat's shareholders to reject the offer, on the basis that it materially undervalues the company, and encourage management to negotiate a fairer price.

Takeaway.com will have to make a formal offer before 24 August. If it goes ahead, Just Eat shareholders will receive 0.09744 Takeaway.com shares in return for each Just Eat share.

We suggest shareholders sit tight in anticipation of a better offer from Takeaway.com or the outside chance of a counter-offer.

**Just Eat shareholders will own 52.2% and Takeaway.com 47.8% of the combined share capital**





# Centrica, Reckitt Benckiser, BP and the week's other big news

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

**I**t was a week to forget for **Centrica (CNA)** as shares in the energy company hit a 21-year low following a series of bad news.

Chief executive Iain Conn agreed to step down following a £446m pre-tax loss in the six months to 30 June, and the company slashed its interim dividend by more than half.

Shares in the British Gas owner fell to around 79p, a marked contrast to the 150p they were trading at a year ago.

Whoever replaces Conn will have a tough task, as will incoming **Reckitt Benckiser (RB)** CEO Laxman Narasimhan.

Reckitt revised its full year expectations after a flat first half of its year, impacted by a slowdown in demand for its infant formula products in China.

Also weighing on the results were competitive pressures and its inability to successfully push up prices. Big companies like Reckitt aim to have pricing power, but the firm has faced flagging sales with its Dettol, Durex and Scholl brands.

**London Stock Exchange (LSE)** swirled investor excitement on the FTSE 100 this week as its shares soared to an all-time high of £65.15 following confirmation of its talks to buy data provider Refinitiv for \$27bn.

Together LSE and Refinitiv would be the largest listed global financial markets infrastructure provider.

**BP (BP)** also had a good week despite being hit by lower oil prices. Its shares moved up to 546p after it beat expectations on its version of net income, underlying replacement cost profit, which stood flat at \$2.8bn in the second quarter, better than the \$2.46bn forecasted.

**Sports Direct (SPD)** on the other hand had a terrible time as its shares started the week over 25% down following its delayed results debacle.

The company hid at the bottom of its results document a shock €674m tax bill from the Belgian authorities, something which led its auditor Grant Thornton to quit.

## FTSE 350 MOVERS OVER THE PAST WEEK

### BEST PERFORMERS

STOCK	SHARE PRICE RISE	REASON
Cobham	39.4%	Takeover offer from US private equity group Advent
Just Eat	24.4%	Merger proposal from Takeaway.com
Vodafone	16.1%	Unveils plan to spin off European mobile mast business

### WORST PERFORMERS

STOCK	SHARE PRICE FALL	REASON
Aston Martin	-43.1%	Reports a slump in sales
Sanne	-28.7%	Warns of weaker operating margins
Metro Bank	-19.9%	Reports 84% drop in half year pre-tax profit

Source: Shares, SharePad. Data as of 30 July 2019

# Softcat primed for IT outsourcing market share run

Software reseller is already UK's number two but still has big growth ambitions

**T**his is not one of those cuddly toys contestants used to win on Crackerjack, **Softcat (SCT)** is what's called a value-added reseller.

The Marlow-based FTSE 250 member sells a wide selection of third party software to small and medium-sized companies and public sector organisations, plus PCs and smartphones. It then offers deep technology expertise and advice on top.

Softcat effectively removes the burden of customers managing multiple IT products and service relationships by using it as a trusted point of contact. That's an immensely valuable service, especially in an increasingly digitised world.

The company has a string of industry accreditations with many blue-chip household software suppliers, such as Microsoft, VMware, Cisco Systems, IBM and HP, plus it's the biggest reseller of products from cyber security firm **Sophos (SOPH)** in the UK.

The model works; in 15 years revenue has jumped from £50m to close to £1bn, while the company has become the UK's number two value-added reseller. Seven years ago it ranked ninth.

We believe investors are underestimating the growth

**SOFTCAT**  **BUY**

(SCT) 959.5p

Stop loss: 768p

Market value: **£1.92bn**



ambition and potential. Analysts calculate that Softcat currently has a 6% market share with forecasts for it to move closer to 9% by 2021. Yet the firm's chief executive Graeme Watt believes £2bn of revenue is on the cards over the next few years, implying 11% or 12% market share is being targeted by management.

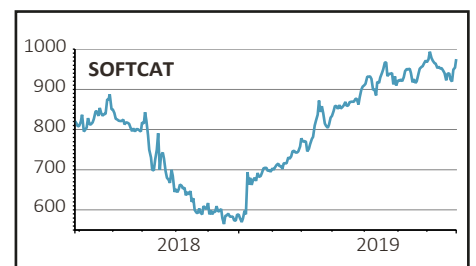
Importantly, this will not be at the expense of profit because the company leaves loss-leading contracts for others to fight over. This is best measured by tracking Softcat's customer growth, its gross profit per customer and by calculating operating profit as a percentage of gross profit, which was running at about 36% at the half year in January.

The company said on 25 July that operating profit for the year to 31 July 2019 will beat expectations, pitched at about £83.5m. That's expected to rise to £87.5m for the year to

July 2020.

Softcat will face challenges, not least from those periodic IT and software upgrade weak spells. There's also the chance that public sector spending slows as the UK grapples with Brexit. But Softcat has a long track record of managing these sort of challenges and prospering, which explains why the shares are so highly rated.

The stock is trading on a rough 2020 price-to-earnings multiple of 26.8. The growth potential is there for the longer-term, plus a rough 3.8% free cash flow yield and it pays dividends, including specials when surplus cash builds up.



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# FTSE 250 gold miner Centamin is starting to shine again

Snap up its shares as operational setbacks become history

**F**or those who are nervous about where the world is heading, one way to potentially take comfort (and profit) could be through a mining company digging for gold by the Red Sea.

After cutting its production guidance three times last year due to operational issues and suffering from associated share price weakness, FTSE 250 miner **Centamin (CEY)** is starting to win back the market's favour, helped by a stronger gold price.

The miner is targeting 490,000 to 520,000 ounces of gold production this year, ahead of the 484,322 ounces it sold last year.

Gold tends to do well when there is an economic downturn, and its price per ounce has hit six year highs so far in 2019 due to a multitude of global problems, including the US/China trade war, Brexit uncertainty and bubbling tensions in the Middle East.

Centamin says its all-in sustaining costs will be around \$890 to \$950 per ounce. With gold having hovered above \$1,400 an ounce this year, the company stands to make a decent profit.

In addition, the company has around \$300m in cash on its balance sheet as well as no debt – unlike a lot of other

**CENTAMIN**  **BUY**

(CEY) 129.6p  
Stop loss: 85p

Market value: **£1.5bn**



miners – so that gives it some protection should it come into any unforeseen problems, which can never be ruled out with mining companies.

Centamin last month reported an improvement in its business following numerous operational problems in the past year at its Sukari mine. It previously suffered lower grades of gold than expected from the open pit section of its mine and disruption to the process it uses to get the gold out of the ground.

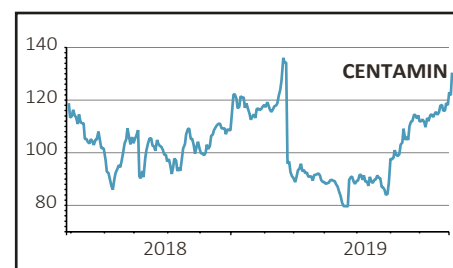
But the firm has moved to reassure investors that it has a 'new team in place' ready to return Sukari 'back to its full potential', having 'identified, evaluated and implemented' solutions to the aforementioned problems.

'Centamin's share price, while off its lows as gold prices have rallied, in our opinion does not reflect any operational

improvements and is pricing in significantly lower than spot and long-term forecast gold prices,' say analysts at investment bank Jefferies.

'With improving free cash flow in 2020 (7% yield), driven by metal price forecasts and modest assumed operational improvements, we forecast the dividend yield returning to 5%, a notable standout versus global gold peers.'

The analysts believe improvements in Sukari's open pit near term, along with stronger free cash flow generation and shareholder returns will drive the equity re-rating.



# Catching up on news from 11 of our Great Ideas

We look at the latest events from Diageo, AstraZeneca, GB Group and more

**T**he *Great Ideas* section of the digital magazine represents our best ideas each week. We try to publish updates as soon as there has been relevant news, but sometimes all the news comes at once and we don't have space to feature everything.

In an effort to catch up on the latest events, we're running the *Great Ideas Update* section in a slightly different format this week as we have 11 stocks to squeeze in.

Identity checker and fraud prevention technology specialist **GB Group (GBG:AIM)** is the best performing *Great Idea* among the ones which have issued news in the past few weeks. The shares have risen by 41.9% since we said to buy last December.

A recent trading update suggests organic revenue and adjusted operating profit are in line with expectation, while management are also continuing to extract value benefits from recent acquisitions.

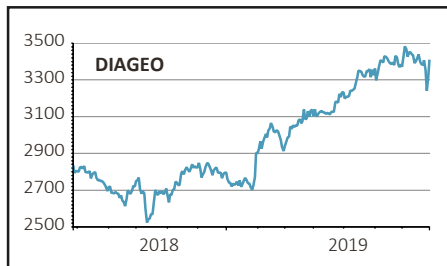
## LARGE CAP GAINS

Shares in **Diageo (DGE)** last week cheapened after the world's biggest spirits company reported full year organic sales growth of 6.1%, slightly below expectations of 6.2%. However, 9% organic operating profit growth beat consensus forecasts of 8.7%.



Shares in Diageo have risen more than 23% since we said to buy last summer

Investment bank UBS says investors may be disappointed by guidance for £4.5bn cash returns over the 2020 to 2022 financial years.



Despite these issues, anyone who bought the shares following our article last summer which outlined the investment case would have subsequently made 23.2% gain, excluding dividends.

Also in the large cap space, pharmaceutical giant **AstraZeneca (AZN)** has performed well since we said to buy last November, up 13.9% compared with a gain of 9.4% for the FTSE 100 index.

Second quarter results reported on 22 July showed strong progress from oncology, which saw a 57% rise in sales to \$2.17bn.



The company now expects full year sales to increase in low double digits, up from previous guidance of high single digits. Total product sales topped analysts' expectations by 5% to reach \$5.72bn.

Chief executive Pascal Soriot believes five of the company's new medicines will become blockbuster drugs this year.

## A RECENT SUCCESS

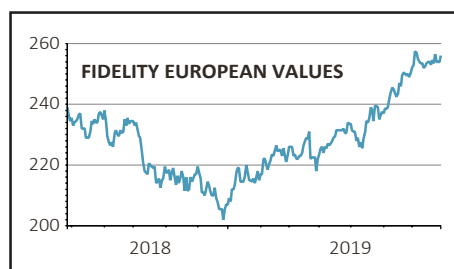
Pushing through operational efficiencies and keeping its own sales teams on the ball has helped **Judges Scientific (JDG:AIM)** to perform well, feeding through to a rising share price.

It's been tough for UK manufacturers but Judges provides niche product lines where margins can be protected when volumes fade. Its underlying first half order book is worth 13.2 weeks of annualised sales and the company says it is confident that full year market expectations will be achieved.

## A PAIR OF INVESTMENT TRUSTS

We outlined the investment case

for **Fidelity European Values (FEV)** at the start of 2019 and in the six months to 30 June the investment trust has increased its net asset value (NAV) by 19.9% and its share price has risen by 24.5%, both well ahead of the benchmark.



Manager Sam Morse remains cautious on the outlook for European equities and the portfolio remains focused on 'defensive growth' stocks which can be bought at reasonable prices. The fund is overweight healthcare and technology stocks and underweight consumer and utility stocks.

The discount to NAV has shrunk from 11.4% in January to just 6%, and the board is committed to keeping it in single digits, with the option to buy back shares if necessary.

Our 21 March 2019 'buy' call on **Law Debenture (LWDB)** is modestly in the money. Half year results (24 Jul) revealed a good start to 2019 for the investment trust which looks for quality companies with the potential for long-term growth and which have been mispriced by the market.

FTSE 250-listed Law Debenture, which in addition to a portfolio of stocks managed by Janus Henderson provides services to corporate trust and pension trustees, generated a credible NAV total return of 10.3% and upped the interim



dividend by 10% to 6.6p. A £10,000 investment in Law Debenture a decade years ago would be worth £36,050 as at 30 June 2019.

### SLOW START FOR TWO PUB COS

Shares in pubs, lodging and brewing group **Marston's (MARS)** are roughly where we said to buy in June.

The shares were weak following the 24 July trading update, which showed like-for-like sales growth slowing to 0.5% from 2% at the half year stage, impacted by tough comparatives.

However, the company announced an acceleration of its

debt reduction plans, proposing to defer £70m of new build investment in order to reallocate £20m to £30m into organic capital expenditure, which is expected to get a higher return.

This will allow the company to generate an additional £40m to £50m of cash flow over the next three years.

**Fuller, Smith & Turner (FSTA)** has also been quiet in terms of share price movement.

There has been a lot of operational change for investors to digest, including the sale of the brewery business.

Once the new finance director Adam Councill takes up his new role in August, investors

### PERFORMANCE DATA FOR A SELECTION OF OUR GREAT IDEAS

STOCK	ENTRY PRICE	ENTRY DATE	PRICE NOW	GAIN/LOSS TO DATE
GB Group	422.5p	20/12/18	599.64p	41.9%
Diageo	£28.02	2/8/18	£34.52	23.2%
Judges Scientific	£28.50	11/4/19	£34.80	22.1%
Fidelity European Values	214.5p	17/1/19	256.87p	19.8%
AstraZeneca	£63	15/11/18	£71.78	13.9%
Law Debenture	578p	21/3/19	604p	4.5%
Marston's	107.2p	6/6/19	107.9p	0.7%
Fuller's	£10.70	14/2/19	£10.75	0.5%
SThree	290p	23/5/19	284.5p	-1.9%
FDM	924p	4/4/19	827p	-10.5%
Sopheon	930p	13/9/18	762p	-18.1%

Source: Shares, latest data taken 30 July 2019

are expecting the company to articulate the new strategic direction of the company as well as announce the return of £50m to £69m of cash to shareholders.

**THE LAGGARDS**

Specialist recruiter **SThree (STHR)** reported a 10% increase in net fee income and a 21% jump in operating profit in the first half to 31 May.

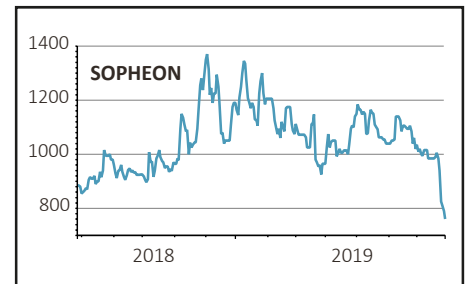
The firm continues to benefit from strong growth in its core science, technology, engineering and mathematics (STEM) markets, particularly the US and Europe, as well as a rising proportion of contract revenue which have higher profit margins.

IT skills supplier and consultant **FDM (FDM)** always

seems to get caught up in Brexit talk yet investors don't seem to give it credit as a broad-based business operating all over the world.

Half year results showed revenue up 14%. 'The group is seeing good growth in most areas, but is being held back by UK Government sector and North American financial services weakness,' note analysts at Shore Capital.

Elsewhere, innovation platform supplier **Sopheon (SPE:AIM)** has taken a battering after warning of licence delays that will wipe out growth this year. That's a blow after three years of rapid growth and something that's caused analysts to downgrade their



earnings expectations.

'The momentum in the strong pipeline remains unchecked; however, client behaviour has moved more rapidly than expected towards cloud consumption rather than perpetual licences,' says FinnCap analyst Andrew Darley. 'Revenue recognition is therefore protracted – even as client commitment and multi-year contracted revenue visibility are improved.'

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# US tech firms (mostly) shine in latest quarterly earnings season

Alphabet, Microsoft, Facebook and Amazon continue to capture the market's attention

**T**he FANGs and other big US tech stocks are being viewed through the lens of record high share prices by investors worried about a US stock market on the point of overheating.

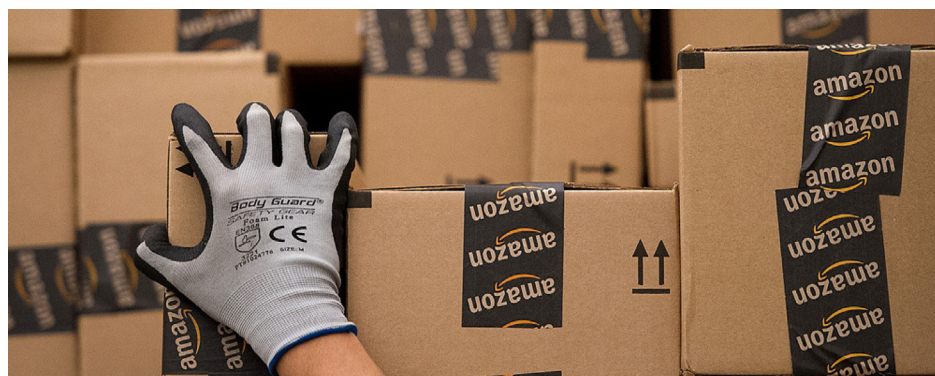
Yet many of the biggest and fastest-growing tech companies are still knocking the ball out of the park when it comes to earnings, based on the latest quarterly updates.

FANG stocks are Facebook, Amazon, Netflix and Google (officially called Alphabet), a well-used grouping of some of the fastest growing big tech stocks in the world.

Quarterly earnings were mixed across the broader spectrum yet the undercurrent is still hugely positive in both growth and stock performance terms, led by better-than-expected earnings from Alphabet and Facebook with knock-out revenue and user growth posted by Twitter, although there was negative market reactions to both Amazon and Netflix.

## ROBUST EARNINGS POWER US MARKETS TO NEW RECORDS

The updates helped US stock markets to close at new record highs. The tech heavy Nasdaq Composite closed last week



at 8,330.21, and even the more broadly-based S&P 500 continued its run of record-breaking closes above 30,000, ending the session at 30,025.86.

This week's expected interest rate cut by the Federal Reserve is likely to fuel further performance optimism in the weeks and months ahead.

Alphabet led the way with the stock jumping close on 10% to \$1,245 after posting a 34% jump in quarterly earnings, its biggest year-on-year gain in three years. Revenue rose 19% as it staged a remarkable recovery from the previous quarter's weak internet advertising growth rates that had many investors worried.

**ALPHABET QUARTERLY EPS VS CONSENSUS**

**\$14.21 VS \$11.33**

To cap things off Alphabet said its cloud computing business is now on an \$8bn a year revenue run-rate and it unveiled plans for a \$25bn share buyback. The cloud business news is particularly encouraging for investors because it has historically lagged behind rivals Amazon and Microsoft.

This represents a stunning return to favour for the internet advertising and search giant considering that its stock had plumbed depths of \$1,038 as recently as 3 June.

## FACEBOOK'S \$5BN FINE

In the social media space Facebook reported better-than-expected second quarter earnings although that was offset by confirmation of its record-breaking \$5bn privacy fine settlement with the Federal Trade Commission for past infringements.



## FACEBOOK QUARTERLY EPS VS CONSENSUS

**\$1.99 VS \$1.88**

Revenue growth of 26% showed acceleration on the previous quarter and it is worth noting that while the shares eased back modestly to \$199.75 following its earnings update, the stock remains an astonishing 47% up year-to-date.

Twitter also jumped 10% to \$41.96 after beating revenue and user growth estimates, while Snapchat-owner Snap reported lower than anticipated quarterly losses and strong revenue and user growth. Snap's shares rocketed to \$17.87, its highest in well over a year.

### AMAZON'S LONG-TERM FOCUS

More frustrating for long-term investors will be the negative reaction to a modest earnings miss by Amazon. The online shopping and cloud computing giant's \$5.22 per share of earnings fell short of analysts' \$5.57 estimate. Its shares dipped 1.6% to \$1,943 in response.

This was largely caused by lavish investment (about \$800m) to expand its one-day Prime deliveries designed to seed future growth, a move that many longer-term stock owners would support.

## AMAZON QUARTERLY EPS VS CONSENSUS

**\$5.22 VS \$5.57**



## MICROSOFT QUARTERLY EPS VS CONSENSUS

**\$1.37 VS \$1.21**

Another negative data point lurking in the update came from its Amazon Web Services cloud computing arm, or AWS as it is typically known.

The unit saw revenue growth dip below 40% for the first time at 37%.

Investors were also concerned with falling subscriber numbers in the US for Netflix while overseas expansion slowed too. Overall subscribers grew by 2.7m to 151.56m but this was well short of the company's forecast of 4.7m and the 5m net additions that were expected by the market.

The on-demand streaming TV market is getting tougher by the day with Disney and AT&T joining Amazon Prime and a host of others. Which makes it possibly illustrative that Netflix's subscriber slowdown was more acute in markets where Netflix has been forced to increase prices in order to keep up with its heavy content spending.

### MICROSOFT DRIVES AHEAD

There were more impressive

fourth quarter 2019 results from Microsoft, showing another strong headline performance. Total revenue growth of 12% to \$33.7bn was ahead of market estimates of \$32.8bn while adjusted operating profit was up 20% to \$12.4bn.

As we flagged in [our recent in-depth look at Microsoft](#), its Azure cloud computing business goes from strength to strength, growing 64%, albeit to an unspecified number.

Microsoft barely moved on the day (adding \$0.15 to \$136.42) yet it is worth noting the stock was already close to record highs, a mark the shares have subsequently surpassed again.

We recently launched a new series of articles analysing the major overseas-listed stocks and will look at some of the FANGs in more detail in future editions of *Shares*.



By **Steven Frazer**  
News Editor



## 5 companies to buy in the stock market summer sale

There's a reason people queue up outside shops at dawn on 26 December, and it's not just to get away from annoying relatives. We all love a bargain, picking up quality merchandise when it is on sale and often we only have a short window to play with.

A similar logic can apply to the stock market. Sometimes quality stocks can trade at knockdown prices but typically

not for that long. After doing some number crunching and then putting its collective brainpower to work, the *Shares* team has identified five stocks worth buying now while they are marked down, some by more than a third.

Our quintet of cut-price stocks are soft drinks outfit **A.G. Barr (BAG)**, oil company **Cairn Energy (CNE)**, IT firm **Craneware (CRW:AIM)**, posh

mixers maker **Fevertree Drinks (FEVR:AIM)** and prospective potash producer **Sirius Minerals (SXX)**.

All were trading at a 10% or more discount to their 200-day moving average when we screened the market for opportunities. A moving average is something which helps you see the wider trend in a share price and smooth out the impact of short-term volatility.

#### WHY HAVE THE SHARES FALLEN?

Share prices can fall for all sorts of reasons. At times of market panic, selling can be both disproportionate and indiscriminate.

We took advantage of this situation when we added electronic equipment manufacturer **Halma (HLMA)** to our *Great Ideas* portfolio following widespread selling in October 2018.

We recognised nothing had ultimately changed about what was an extremely good business and recommending buying at £12.62. As we write the shares trade at £20.11, representing a significant gain on our entry price. We would not necessarily expect all of our ideas to generate returns on this scale but double-digit gains in a year are a realistic possibility if sentiment towards our list of names in this article shifts.

Buying stocks at an apparent discount doesn't always work and we don't always get it right. The same week we flagged Halma, we also highlighted the potential in ticketing technology firm **Accesso (ACSO:AIM)** and its shares continued to fall.

Investors need to remain alive to changes to the investment case, whether these are driven by internal developments or external developments.

#### QUALITY CONTROL IS NEEDED

Simply screening for cut-price stocks doesn't necessarily mean each one on the list is worth buying. For example, one name appearing on our latest screening exercise is healthcare provider **NMC Health (NMC)** and there are valid reasons for the decline in its shares.

“  
*We all love a bargain*  
”



Founded in 1975, NMC is the largest healthcare provider in the United Arab Emirates and owns and operates over 200 hospitals across more than 15 countries, treating more than 8.5m patients every year.

Its shares are down 44% from their peak in August 2018 and there has been an increase in the 'short interest' since late 2018, meaning that hedge funds and other investors are placing bets that the shares will fall further in value.

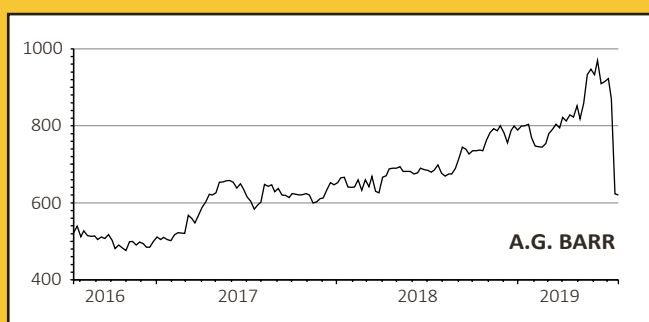
Data from shorttracker.co.uk show that the percentage of the company's shares being used for short selling has risen from 0.5% in November 2018 to 4.73% on 20 July this year.

The negative stance seems to be driven by the acquisitive nature of the company's strategy and suspicions it has grown too fast and that acquisitions are masking poor organic growth. Investment bank Jefferies has also raised concerns around corporate governance, opaque accounting and supply chain finance.

Up until last year investors seemed happy to chase the share price up to £41, which moved further than the fundamentals, thus increasing the valuation of the business. This created a virtuous cycle whereby the company could buy companies trading on lower multiples than itself and announce that the purchase was instantly 'earnings enhancing' for shareholders.

As the stocks has fallen more than the fundamentals and the shares have become cheaper, the dynamics of 'accretive growth' may be more difficult to achieve.

# A.G. BARR (BAG) 620p BUY



## WHY HAS THE SHARE PRICE BEEN WEAK?

A near-40% share price plunge from June's 975p peak at soft drinks group **A.G. Barr (BAG)** presents a buying opportunity for long-term investors looking for a typically dependable, defensive and growing portfolio compounder.

We remain bullish on the long-term earnings potential of Glasgow-headquartered A.G. Barr, whose competitive advantage lies in a portfolio of differentiated soft drinks brands spearheaded by iconic Scottish tippie IRN-BRU, as well as Strathmore, Rubicon and cocktail mixers name Funkin.

A.G. Barr, which recently took a minority stake in non-alcoholic spirits brand STRYK, also benefits from well-invested manufacturing assets and is highly cash generative, progressive dividend paying and able to fund supportive share buybacks.

Its shares slumped on a punishing profit warning (16 Jul) blamed on a strategy shift from a heavy focus on driving volume last year to prioritising value now. Also at play were disappointing spring and early summer weather, most notably in Scotland and the north of England, as well as challenges around its Rockstar energy and Rubicon juice drinks.

Against a prior year comparative boosted by 2018's summer heatwave, A.G. Barr expects

sales for the 26 weeks to 27 July in the region of £123m, roughly a 10% year-on-year decline. Due to operational gearing, investors can expect full year profits to drop by up to 20%.

## WHAT COULD SPARK A RE-RATING?

We believe this profit setback is temporary, mindful of A.G. Barr's otherwise strong track record on execution and delivery.

Current balmy weather offers a positive catalyst for A.G. Barr, already seeing positive indications of consumer acceptance of higher IRN-BRU prices.

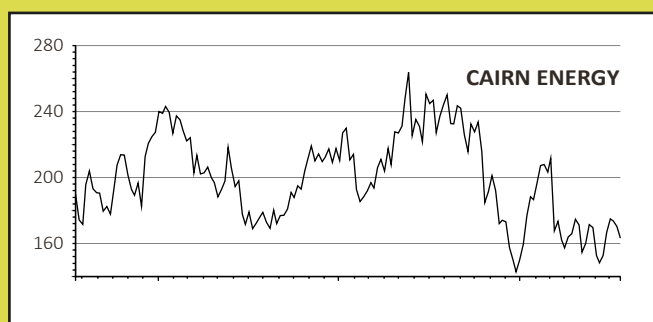
Reassuringly, management has addressed the Rockstar and Rubicon issues with a mixture of new product development and recipe improvements which could boost the second half performance. And remember, A.G. Barr has scope for soft drink distribution wins, boasts a strong balance sheet and, given a largely UK sales profile, Brexit looks less of an issue for the FTSE 250 firm than for internationally-focused beverage rivals.

For the year to January 2020, Shore Capital now forecasts adjusted pre-tax profit of £36.1m (2019: £45.2m), with profit rebuilding to £37.2m and £38.4m in 2021 and 2022 respectively.

Following this year's material downgrade and based on estimated earnings per share of 25.6p and a 17.1p dividend, A.G. Barr remains optically expensive on a prospective price-to-earnings ratio of 24.2-times with a modest 2.8% yield. Yet we believe the shares merit a premium rating and this pullback presents a compelling new entry point for patient investors.



# CAIRN ENERGY (CNE) 162.6p BUY



## WHY HAS THE SHARE PRICE BEEN WEAK?

Beyond the oil price volatility which has hit most of the wider sector there have been several company-specific issues weighing on Cairn's share price. Key has been a hold-up in arbitration proceedings over a long-running Indian tax dispute, where Cairn is seeking \$1.4bn in compensation.

A reserves downgrade for its Kraken field in the North Sea earlier this year did little to help sentiment, particularly as write-offs associated with both these setbacks saw the company post a \$1.27bn net loss in March. More recently the company announced a disappointing result from its Lynghaug well in Norway.

There has also been a slight delay in the final investment decision on its highly prized SNE development in Senegal. Funding this project might require bringing in an additional partner and selling down some of its current 40% stake.

## WHAT COULD SPARK A RE-RATING?

If the first part of 2019 has seen a run of a bad news then there are reasons to feel more positive about the remainder of the year and with the shares trading close to multi-year lows Cairn could enjoy a significant second-half bump.

A price-to-earnings ratio of 16.8-times is higher than you might imagine given the recent

bad news, yet this rating reflects the company's continuing investment in development and exploration assets.

Encouragingly the balance sheet is in rude health, with \$66m of cash at the last count and just \$85m drawn from a \$575m reserves-based lending facility.

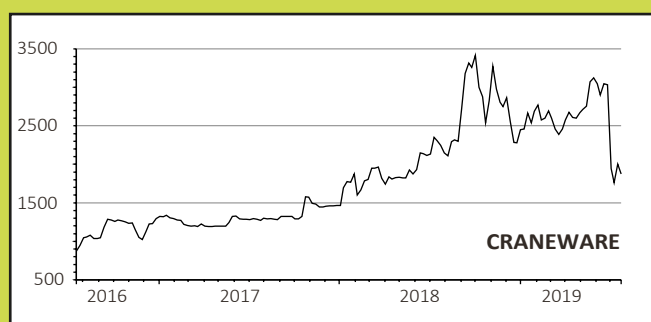
In terms of specific catalysts for the share price, a multi-well drilling campaign in Mexico targeting upwards of 500m barrels of oil equivalent could have a significant positive impact on the share price in the event of success.

In order to get the market back on side, Cairn needs to deliver strong operational performance and ultimately production from its North Sea oil fields Catcher and Kraken, and this is likely to be in focus when the company announces its first-half year results on 10 September.

Deliberations on the Indian tax case are not likely to conclude until the end of the year but a successful outcome could be worth as much as 190p per share. However, expecting India to abide by any ruling in the company's favour might be wishful thinking. At least Cairn is protected from any unfavourable decision which would be ring-fenced to the Indian interests.



**CRANEWARE**  
**(CRW:AIM)**  
**£18.75**  
**BUY**



#### WHY HAS THE SHARE PRICE BEEN WEAK?

Made-in-Britain **Craneware (CRW:AIM)** shows that even the best of companies sometimes get caught up in temporary logjams. In June the billing and healthcare analytics software supplier revealed a sharp slowdown in sales, meaning it would miss full year expectations.

Where the market had been anticipating revenue and adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) of \$79.5m and \$25.6m respectively, the company actually reported \$71.1m and \$23.8m. Importantly, growth metrics will miss the near-20% expected, posting 6% and 10% instead.

At the core of the issue is Trisus Health Intelligence, Craneware's recently launched cloud-based analytics platform. Developed over many months, it combines the best of the firm's core price, cost and compliance features with new financial, operational and clinical data tools.

This new, even more feature-rich platform is more complex and getting its US hospital customers to understand its power to slash costs, drive new revenue streams and speed up administration takes that bit longer.

Management is clear that there is nothing in worries about market share losses or intensifying competition, flagging unchanged renewal levels alongside 'a significant and growing pipeline'.

#### WHAT COULD SPARK A RE-RATING?

Demonstrating this situation is temporary will obviously be vital in getting the share price going again, and Craneware certainly has a hard-earned reputation for operational excellence to lean on.

That the company dominates its niche, earns only recurring revenues on average five-year contracts, and enjoys an entrenched competitive position at the top of its industry, makes a quick return to more exciting growth very likely.

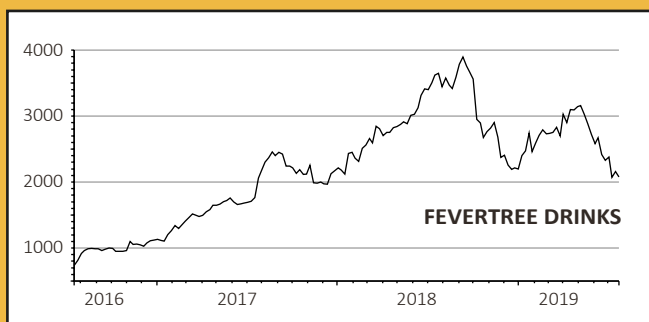
Craneware already supplies its software analytics tools to almost a third of the hospitals in the US. It uses automation to highlight operational and financial risks, plus identify new income opportunities to healthcare management. The company estimates that it can help an average 350-bed hospital tap an extra \$22m a year of revenue.

The financial health of all US hospitals is already faced with challenges as the healthcare system across the pond transitions to a value-based approach. That the Trump administration continues to implement regulations on pricing transparency will only intensify the pressure, and support Craneware's long-term value-cycle strategy and place it as a key trusted hospitals technology partner.

The long-run opportunity justifies the 2020 price-to-earnings multiple of 34-times, and we believe Craneware is a core growth holding for the long-run.



**FEVERTREE  
DRINKS**  
(FEVR:AIM) £20.79  
**BUY**



#### WHY HAS THE SHARE PRICE BEEN WEAK?

Shares in upmarket mixer brand **Fevertree Drinks (FEVR:AIM)** have been on something of a rollercoaster. Having started the year at roughly £22, they raced up to £32 by the end of May only to give back all their gains in the past two months.

Investors have gone through a whole range of emotions, from optimism and euphoria to disappointment and despondency.

When the long-awaited first-half results were released last week, revealing that sales growth had slowed to 13% and earnings growth had slowed to just 7%, many holders capitulated and sold out.

The shares lost almost 10% on the day of the announcement, the second time this year that they have been heavily punished for not meeting expectations.

In common with other drinks companies Fevertree had a blow-out start to the summer last year thanks to a combination of hot weather and big sporting events which boosted UK sales.

This year the summer has got off to a soggy start, and with no major events to celebrate. Sales have been steady but growth is well below last year's levels.

Ironically the first-half results came out as much of the UK was experiencing its hottest July

ever so it is quite possible that the third quarter will see a strong rebound in consumption but we won't know for some time.

The UK still represents roughly half of group sales so a slowdown to 5% growth in the first-half has acted as a major drag on the numbers.

#### WHAT COULD SPARK A RE-RATING?

The major growth driver for Fevertree going forward is the US market, where it had shown reasonable growth for 10 years via its agent but decided 18 months ago to take a much more hands-on approach and manage it directly.

The step-change occurred last summer when the group signed an exclusive on-trade distribution deal with SGWS, the largest North American wine and spirits distributor.

Given the size of the US market (estimated to be 16 times the size of the UK mixer market) and the increasing trend towards premium drinks and mixers, even a small increase in its current 11% market share would mean a significant increase in sales and earnings over time.

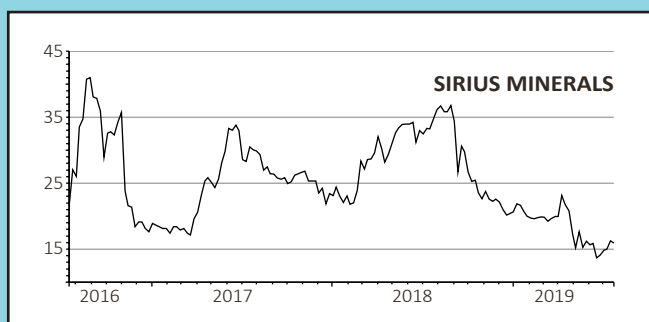
According to S&P Global Intelligence, pre-tax profit is forecast to rise from roughly £75m last year to £106m in three years, bringing the price-to-earnings (PE) ratio down from 41-times to 28-times.

Yes, the shares command a premium rating but we believe the company continues to have a very strong outlook with scope to deliver large earnings growth for years to come.

Current share price weakness may even spur takeover interest from trade players such as **Diageo (DGE)** and **Unilever (ULVR)**, or private equity.



# Sirius Minerals (SXX) 16p BUY



## WHY HAS THE SHARE PRICE BEEN WEAK?

Potash miner **Sirius Minerals (SXX)** needs a lot of cash if it is to turn its potentially money-spinning polyhalite mine in North Yorkshire into a reality.

The FTSE 250 firm has moved a step closer to that reality after it felt confident enough to launch a \$500m bond, part of its efforts to raise \$3.8bn so it can carry on with building the mine.

Investment bank JP Morgan has agreed to stump up a \$2.5bn overdraft if Sirius gets investors to take on the \$500m bond. Combined with \$400m in convertible bond sales and \$425m raised via issuing new shares, Sirius will have the cash it needs if it can get the latest bond money.

But what has got investors so annoyed with the company is the \$425m it raised from new shares, which it bagged by offering them at 15p a share – a significant discount to the 21.9p the shares closed at the day before the placing.

In addition, the cost to build the mine has consistently gone up in the last few years, with Sirius asking for more cash every time.

Having sat at 45p three years ago, its shares are now trading at much lower levels despite the project being more advanced.

## WHAT COULD SPARK A RE-RATING?

If it gets the bond money that would effectively

eliminate the financing risk with regards to the project.

And analysts covering the stock believe it's highly likely Sirius will get this cash, meaning the shares could be in for a major re-rating, with Shore Capital analyst Yuen Low saying it is the 'key to effectively unlocking Sirius's vast potential'.

Despite the mine being years from production, Sirius has already secured several offtake deals – which is what led JP Morgan agreeing to lend it a huge chunk of the cash – with more in the pipeline, evidence both of the demand for a product whose market does not yet exist, and customers' belief that Sirius will get this off the ground.

It started a roadshow for the bond last week, with the bond pricing on 6 August and the deal closing on 9 August.

Once the finance is in place, investors will start to focus more on the opportunity for Sirius as a supplier of multi-nutrient fertiliser and how it can help to improve crop yields around the world.

Despite the potential to be a major employer in the UK and for the shares to re-rate dramatically, investors should not lose sight of the fact that this is a higher-risk investment. There are geological, project execution and market risks to consider, as well as the pressure on Sirius to operate the mine profitably and be able to pay down its sizeable debt.



By Tom Sieber, Ian Conway, James Crux, Yoosef Farah and Martin Gamble



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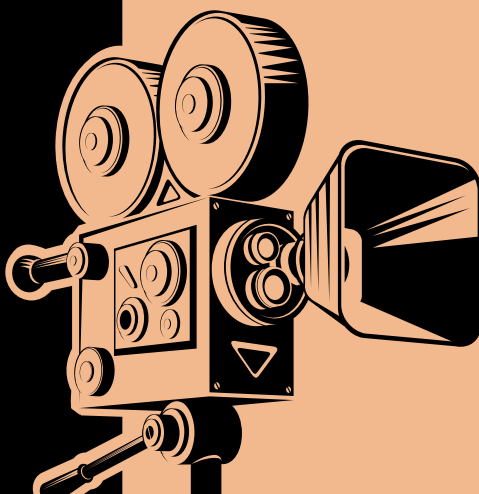
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# Know your fund: what's inside Fundsmith Equity?

Terry Smith's creation is one of the best and most popular funds for very good reasons

Following our [cover story](#) on the risks associated with 'star managers', in the aftermath of the suspension of the flagship **Woodford Equity Income Fund (BLRZQ73)**, we are launching a new feature looking at the UK's most popular funds to analyse their investment process and their top holdings.

As we explained previously, when choosing a fund or trust it's important to understand the manager's process and why they own what's in their portfolio. If you don't understand or don't feel comfortable, then don't invest.

## STAR QUALITY WITH A CLEAR PROCESS

One of the biggest and most successful funds since its launch in 2010, **Fundsmith Equity (B41YBW7)** is now valued at £18.3bn. Founded by star analyst-turned-fund manager Terry Smith, it has a very simple three-step investment process: buy good companies, don't overpay and do nothing.

Rather than having a glossy brochure, the fund has a 20-page 'Owner's Manual' for investors because 'your understanding of what we are trying to achieve and how we will approach it is a critical element in enabling us to attain our goal'.

## WHAT DOES IT SAY ON THE TIN?

Fundsmith invests in equities



Guinness owner Diageo is in the portfolio

across the globe on a long-term basis using 'stringent investment criteria' to select only businesses:

- which are high-quality and can sustain a high return on operating capital employed (ROCE)
- whose advantages are difficult to replicate
- which do not require significant leverage to generate returns (therefore typically not banks or utilities)
- with a high degree of certainty of growth from re-investing their cash flows at high rates of return
- which are resilient to change, particularly technological innovation
- businesses at attractive valuations

By sticking to these criteria Fundsmith builds a portfolio of 'resilient businesses with excellent performance'. Importantly, it is structured 'to survive Terry Smith's demise and continue with the same investment philosophy'.

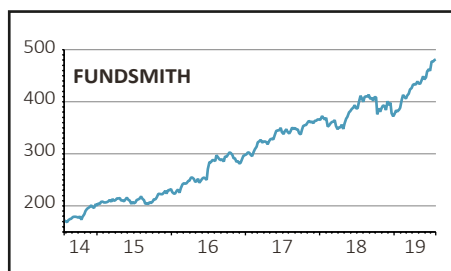
The fund is also clear on what it *won't* do: trade short-term or attempt to time the market, adopt hedging strategies or use derivatives, 'hug' the index, short stocks, or charge upfront fees or performance fees.

## HOW DOES IT WORK IN PRACTICE?

With such a rigorous selection process it's not surprising that few stocks make the grade. As the fact sheet explains, 'the application of these investment criteria significantly limits the number of potential investments'.

The current number of holdings is 27, towards the top of the estimated range of 20 to 30 holdings at any given time. In the last year the portfolio turnover ratio – the percentage of the fund which has changed – is just 13.4% meaning only three or four stocks have been bought or sold.

Even more impressive, 11 of the stocks in the portfolio at the end of last year had been there since the fund was launched in 2010. This is the 'do nothing' approach. Good companies



look after themselves and shareholders.

The top 10 holdings as of the end of June were, in descending order:

Paypal, Microsoft, Facebook, Amadeus, Idexx, Estee Lauder, Intuit, Philip Morris, Stryker and Novo Nordisk.

If we assume most investors will know half of these stocks, then for those who are unfamiliar with the other half:

Amadeus owns and operates the world's number one travel distribution and reservation computer system and is listed in Spain.

Idexx designs and markets diagnostic testing equipment for monitoring animal health and analysing dairy products and is listed in the US.

Intuit produces accounting management and payroll software, not dissimilar to London-listed **Sage (SGE)**, and its shares are also traded in the US.

Stryker designs and markets orthopaedic and surgical equipment, and is a rough lookalike for **Smith & Nephew (SN.)**, and is listed in the US.

Finally, Novo Nordisk is one of the world's leading producers of insulin and is listed in Denmark.

**PERFORMANCE DATA**

Every month the fund records its performance and explains which stocks added or detracted

FUNDSMITH TOTAL RETURN COMPARED WITH OTHER ASSETS			
PERIOD	FUNDSMITH	EQUITIES	UK BONDS
From inception to June 2019	358.0%	167.3%	40.0%
Jan-June 2019	23.9%	17.1%	3.1%
2018	2.2%	-3.0%	1.2%
2017	22.0%	11.8%	1.4%
2016	28.2%	28.2%	6.5%
2015	15.7%	4.9%	1.0%
2014	23.3%	11.5%	10.0%
2013	25.3%	24.3%	-4.8%
2012	12.5%	10.7%	2.7%
2011	8.4%	-4.8%	15.6%

Equities = MSCI World Index in GBP, UK Bonds = Bloomberg/Barclays/EFFAS Bond Indices UK Govt 5-10yr Fund launched 1 November 2010

the most from returns. In June, the fund gained 3.8% thanks to positive contributions from Stryker, Estee Lauder, Idexx, Microsoft and Novo Nordisk. The worst performers were **Reckitt Benckiser (RB.)**, Philip Morris, McCormick, **Unilever (ULVR)** and **Diageo (DGE)**.

Up to the end of June the fund had gained just under 24% so far this year against 17% for its main benchmark, the MSCI World Index priced in sterling.

Last year, when 92% of UK funds in the Investment Association universe posted negative returns along with the stock market, Fundsmith posted a 2.2% gain putting it in the top 4% of performers.

Since launch on 1 November 2010, the fund had racked up gains of 358% to the end of June 2019 compared a return of 167% for the MSCI World Index and a return of 40% on UK five-year and 10-year Gilts (government bonds).

Importantly, it has a lot more up months than down months (roughly 70/30) and when it

has a bad month the losses are smaller than in good months (best month +9.4%, worst month -6.9%). Therefore its average monthly return is +1.5%.

Finally, for those worried about liquidity, Fundsmith only invests in large, liquid stocks and has no unlisted holdings whatsoever. Despite its size, the managers say that 60% of the fund could be liquidated in seven days if it were ever necessary.

**SHARES SAYS:** ↗  
**Fundsmith excels at communicating its strategy. The fund's process is crystal clear and only picks long-term winners. It is also designed to survive Terry Smith's demise as the manual says cheerfully. It is easy to see why this is the UK's most popular fund. Buy and hold for the long term.**



# How to play a surge in Chinese domestic consumption

Fidelity's China guru aims to invest in undervalued stocks with a bias towards small and mid caps

**A** number of global, emerging market and thematic investment trusts put money to work in China, but there are just two dedicated China trusts within the investment companies sector, namely **JPMorgan Chinese (JMC)** and **Fidelity China Special Situations (FCSS)**. This pair have had a tough time of late.

The US/China trade dispute continues to weigh heavily on sentiment, credit growth is slowing and China's GDP growth is trending downwards, forecast to reduce from 2017's and 2018's respective 6.9% and 6.6% to 6.2% this year and 6% in 2020.

However, earnings growth in China remains strong and although it has proved a volatile market, valuations remain attractive versus history and global peers.

## MISPRICED POTENTIAL

Seeking to achieve long-term capital growth from companies listed in China or Hong Kong, and Chinese companies listed elsewhere, Fidelity China Special Situations has had a challenging past 12 months with performance impacted by a significant sell-off in Chinese equities.

The positive news is that the



longer term showing remains strong in absolute and relative terms, while Hong Kong-based portfolio manager Dale Nicholls' focus on cash-generative companies has resulted in a steadily-rising dividend.

Manager of the fund since April 2014, Nicholls insists there are notable investment opportunities in China, where the middle class is developing rapidly and his focus is on higher growth, consumer-led sectors accordingly.

Nicholls looks for undervalued companies that can deliver over the long term, believing the best investments are companies with good long term growth prospects – he asks himself 'how big can a company be in 10 years' time?' – and also cash-generative businesses controlled by strong management teams. Ideally,

Nicholls would look to buy at an attractive valuation.

## NEW CHINA ECONOMY

Nicholls favours sectors with strong structural growth prospects, mainly related to rising domestic consumption, China's growing middle class and ongoing structural reforms. The consumer, information technology and healthcare sectors, so-called 'New China' areas where innovation remains high, continue to excite.

'I have a mid to small cap bias,' he explains. 'When companies are smaller they are less well covered by the market and I am investing in mis-priced stocks that can move to fair value over time.' Company meetings and site visits are a key part of Nicholls' process as risk management takes on increased

importance when investing in small caps.

Albeit diversified across 120-to-150 holdings, the portfolio's small and mid cap tilt has been a performance drag with Chinese small caps underperforming over the past two and a half years. Over the 12 months to 30 June 2019, Fidelity China Special Situations' net asset value (NAV) declined by 12.8%, significantly underperforming a 3.2% drop for the MSCI China index.

Yet Nicholls appears as excited as ever about the domestic Chinese opportunity given 'the natural development of the middle class. As people get richer, you will increasingly see a trend towards premiumisation'.

#### UNLISTED OPPORTUNITIES ABOUND

A potential advantage for Fidelity China Special Situations is its closed-ended structure, which means Nicholls has less liquidity constraints and can also use futures, options and CFDs to provide gearing and take short positions. However these types of assets and exposures arguably have a different risk profile to ordinary shares.

The trust is also able to invest in unlisted companies, especially advantageous in the current climate when growth companies globally are coming to the public markets later and later.

'I'm continuing to find a lot of opportunities at the pre-IPO stage,' enthuses Nicholls, whose biggest concern in China has been the build-up in debt, which is also the main reason he owns none of the banks.

Turning to the US/China



trade war, Nicholls says the risk to earnings depends on the particular company in question, although he also stresses that 'the thrust of this portfolio is about the consumption trend in China. Most of the companies I'm investing in are focusing on the domestic market.'

In fact, Fidelity China Special Situations has low exposure to exporters with around 90% of portfolio company revenues derived from Greater China.

'I have some hotel exposure and I also own online travel booking company Ctip.com,' Nicholls continues to find attractive new ideas, such as recent addition Secoo, a luxury e-commerce platform.

Since he took over the running of the trust (1 April 2014), the net asset value (NAV) and share price are up by 121.7% and 128.6% respectively versus 97.3% for the MSCI China index. The top two holdings are Tencent, the internet services and advertising titan; and Alibaba, China's largest e-commerce and cloud provider.

The top contributors to performance in the 12 months to 30 June 2019 included search engine Baidu.

Other leading contributors included luxury car dealer China Meidong Auto; Li-Ning, the domestic sportswear brand founded by a former Chinese Olympic gymnast; as well as Macau telecom operator CITIC Telecom International.

About 6% of the portfolio is in unlisted holdings. These include global ride-hailing network Didi Chuxing and ByteDance, which operates various content platforms globally including China's leading news aggregator Toutiao, as well as artificial intelligence technology company SenseTime.

At 222.5p, Fidelity China Special Situations trades at a 9.3% discount to NAV of 245.24p. The discount, which has ranged from 5% to 23.4% over the past five years, has recently narrowed below 10% and the board intends to keep it that way, having introduced a formal plan to that effect. We think this is a good trust to own to play the Chinese growth theme.



By James Crux  
Funds and Investment  
Trusts Editor

# Where to start with investing in metals and energy products via ETFs

We explain how the different products work and ways to play three commodities forecast to rise in value

**C**ommodities, which cover everything from oil to copper to corn, play a central role in our lives. They fuel the cars we drive, line the cables which keep us online and some are in the meals we eat.

Investing in this space used to be the preserve of the professionals but several developments, most notably the emergence of exchange-traded funds (ETFs), have enabled ordinary investors to get in on the act.

ETFs track a certain index to mirror its performance. For example, if you buy a silver ETF, it should move up and down in line with the movement of the precious metal.

## DEMOGRAPHICS UNDERPIN COMMODITIES

An increasing global population and the finite nature of many commodities underpins these markets over the long term.

However, while some commodities exposure could be a good fit for a balanced portfolio there are several factors you need to consider if you want to buy a commodity-based tracking product, such as diversification.

Products focused on a single commodity, with the possible exception of gold,

are only appropriate for more sophisticated investors, particularly as the individual markets can see considerable volatility.

Instead it could be more sensible to start off with an ETF which tracks a large basket of different commodities.

An example includes **Invesco Bloomberg Commodity (CMOD)**. However, not all broad commodities indices are created equal and some will be dominated by the larger commodity markets such as oil.

The methodology behind the Bloomberg Commodity Index, for example, seeks to address this situation by adjusting the index weighting to ensure no single commodity dominates the index. In comparison, the S&P GSCI index has an energy products weighting of more than 60%.

## WHAT IMPACT DOES THE FUTURES MARKET HAVE?


A further consideration, which applies particularly to long-term investors, is the impact of the futures market phenomena 'contango' and 'backwardation'. Over time these can have a material impact on returns.

Most commodities are traded in futures contracts. This is the purchase or sale of a commodity agreed at a fixed price for delivery on a specified date – typically either one month, three months or six months ahead.

This facilitates the buying and selling of the respective commodity without anyone having to take physical delivery of a barrel of oil or bushel of corn, for example. Only a tiny fraction of these contracts are settled through deliveries, the bulk are instead 'rolled over'

HOW COMMODITIES INDICES' WEIGHTINGS CAN DIFFER		
	S&P GSCI	Bloomberg Commodity Index
Energy	62%	32.5%
Agriculture	16.5%	27.8%
Industrial Metals	10%	18.5%
Precious Metals	4.7%	15.6%
Livestock	6.9%	5.7%

Source: Bloomberg, S&P



## WHICH COMMODITIES COULD GO UP IN PRICE?

A RECENT PIECE of research by investment bank Morgan Stanley identified several bright spots, namely copper, palladium and tin.

Morgan Stanley believes supply issues could support copper prices and an example of an ETF tracking the base metal price is **ETFS Copper (COPA)**.

It sees continued

upside in palladium prices until mid-2020. Demand currently outweighs supply, which is pushing up the price. **Invesco Physical Palladium (SPAP)** is among the ETFs tracking the value of the metal.

In the long term tin is expected to be a beneficiary of new technology development



Commodity	Q319	Q419	Q120	Q220
Copper (\$/t)	6063	6504	6680	6724
Palladium (\$/oz)	1400	1450	1500	1490
Tin (\$/t)	19842	20944	22046	23149

Source: Morgan Stanley

with the metal widely used in solders. To quote consultancy Roskil it is the metal which

'glues the technology revolution'. Exposure is possible through such ETFs as **ETFS Tin (TINM)**.

to the next month and the pattern repeated.

Contango refers to the market condition whereby the price of a futures contract in a commodity is trading above the spot price (the current market price). The resulting futures 'curve' would be upward-sloping with prices for dates further in the future trading at ever higher levels.

Backwardation describes the reverse – where futures are trading below the spot price – often because of short-term tightness in the underlying market. Arguably contango is a more natural state as it reflects costs of ownership such as storage and insurance.

### COST OF THE ROLL

What does this mean for an investor? When contracts are rolled over to avoid taking delivery of the physical asset, contango sees returns diminished, also known as 'negative roll yield'. Meanwhile, backwardation sees returns

enhanced due to the 'positive roll yield'.

The impact of contango is more acute for investors because the providers of these products do not pay a premium every month to cover the cost of the 'roll' and maintain the same position.

In effect the instrument is giving up a proportion of its position to cover the cost of the roll-over.

WisdomTree research director Nitesh Shah says: 'Most industrial metals have a flat futures curve while precious metals have negligible or no contango or backwardation. Energy markets tend to see more pronounced contango or backwardation. Currently oil is in backwardation but it had been in contango for some time before that.'

'Other markets are very seasonal such as natural gas and lean hogs and you will see that reflected in the futures curve.'

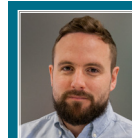
### AN OPTIMISED APPROACH

By adopting different strategies,

some products and indices seek to provide a solution to this problem. These so-called 'optimised solutions' will typically look to buy a selection of different futures contracts to mitigate the negative impact of contango and, in some cases, maximise the positive impact of backwardation.

There are several UK-listed ETFs which fall into this category. Among them are **UBS ETF CMCI Composite (UC15)**, **WisdomTree Enhanced Commodity (WCOG)** and **iShares Bloomberg Roll Select Commodity Swap (ROLL)**.

WisdomTree's Shah believes you need to think carefully about what you are buying and not look to invest in the commodities product with the lowest fee. 'You can't just look at the name; you really need to study the prospectus carefully in order to make an informed decision.'



By **Tom Sieber**  
Deputy Editor

# What we can learn from oil's latest sticky patch

We try to make sense of the oil market and how it is currently viewed by investors

**S**tock markets are generally rising high, especially in the US, but commodity prices are doing nothing of the sort with the occasional, supply-driven exception such as nickel or iron ore. Despite a robust spring rally, the Bloomberg Commodity index is down by around 5% from where it stood a year ago and Brent crude oil is 14% lower.

This could suggest that all may not be entirely well with the global economy, as you would expect to see raw material prices rise if activity and demand levels were high. That said, oil demand is expected to hit a new all-time high in 2019, at a fraction under 100m barrels a day by the end of the year.

Oil's latest sticky patch may be more related to supply than demand. If so, investors need not be too alarmed by weakness in the price of crude.

## RIGS ROLLING OVER

Supply can be quickly gauged. On the face of it, oil's latest wobble is curtailing fresh exploration work, as you would hope and expect. Data from Baker Hughes shows that the active US rig count is 9% lower than it was a year ago and the international count is 3% higher, as oil firms keep a close eye on their expenses and cash flow.

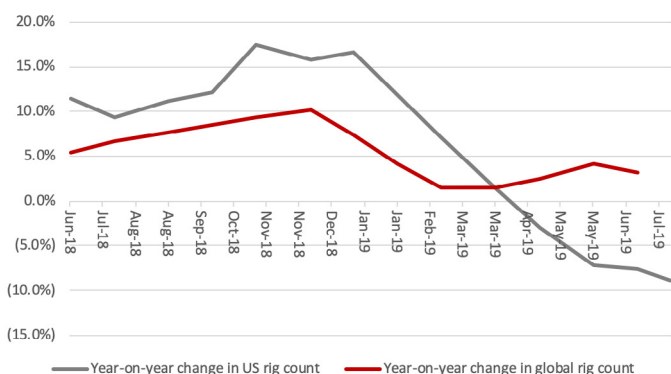


Further good news can be found in the form of falling American oil inventories. US stockpiles of crude are now 9% lower than they were a year ago.

This is despite a sustained increase in American oil and gas output from its onshore shale fields. Oil production is up by some 950,000 barrels a day, or 13%, over the past year.

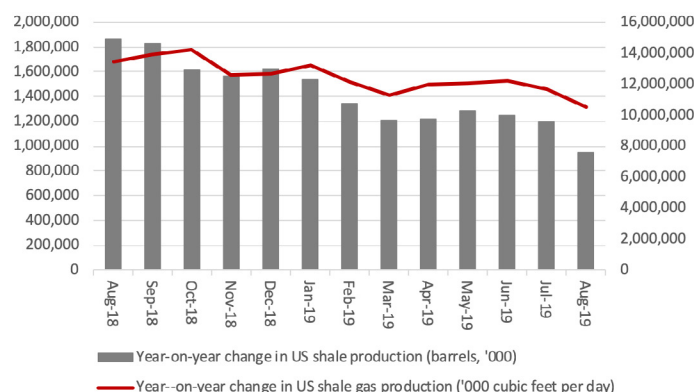
This could be a key factor in capping the oil price, since this surge in output goes a long way to compensating for the 1.2m barrel a day production cut sanctioned by OPEC in Vienna last December and then again in June.

### GROWTH IS GLOBAL RIG ACTIVITY IS SLOWING DOWN



Source: Baker Hughes

### US SHALE OUTPUT GROWTH IS SLOWING



Source: US Energy Information Administration





**ANNUAL OIL CONSUMPTION HAS ONLY FALLEN TWICE SINCE 2000 AND THAT WAS IN 2008 AND 2009 WHEN THE GLOBAL ECONOMY WAS ON ITS KNEES**

Yet growth in shale supply is relatively modest as the annual rate of increase was running at 1.9m barrels year-on-year in August 2018. Any further slowdown in shale growth could actually help oil – at least if OPEC and Russia maintain their current output discipline. Yet even with this deceleration in growth crude remains weak.

One further factor which may be at work is how financial speculators are positioned via the futures market. Each contract is worth 1,000 barrels of oil and the fund flows are huge, easily outstripping actual physical demand.

According to data from the CME, the amount by which the number of speculative ‘long’ (buy) contracts exceeded the number of ‘short’ (sell) contracts peaked at 784,290 in January 2018.

Once the crude price began to roll over, buyers ran for cover and sellers took over. Net long positions shrank to 332,714 contracts in January 2019 and oil hit bottom at the same time. In other

words, as in all markets, running with the herd just gets oil traders badly trampled. They need to go against the crowd.

Buyers have begun to gather again, perhaps emboldened by the diplomatic stand-off between Washington and Tehran, a delicate affair in which the UK is now embroiled after the mutual seizure of oil tankers in Gibraltar and then the Straits of Hormuz. Net long positions have crept back to around 450,000 contracts.

**PUMP UP THE DIVIDENDS**

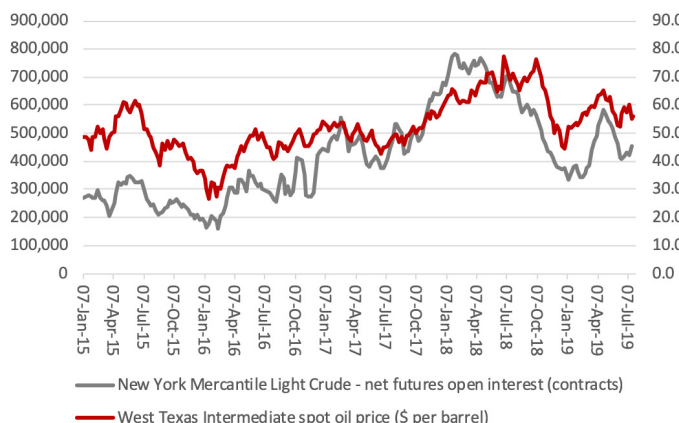
That sits in the middle of the range for the last five years, as if to say even the professionals don’t have a strong feel for where oil is going next, so it would take a brave investor to take a strong view at the moment.

The possible bad news is that oil’s weakness reflects soft demand. Annual oil consumption has only fallen twice since 2000 and that was in 2008 and 2009 when the global economy was on its knees.

The better news is that spikes in oil have tended to act as a brake on global economic activity, as per 1975, 1980, 1990, 2000 and 2007, while relatively stable prices have tended to be a good lubricant.

A quiet oil market is generally more helpful to financial markets overall than a noisy one and the best scenario for investors is more of what we have now, although history also suggests that periods of calm never last for too long.

**NET LONG OIL FUTURES POSITIONS LIE IN THE MIDDLE OF THEIR FIVE-YEAR RANGE**



Source: CME, Refinitiv



By **Russ Mould**  
AJ Bell Investment Director

# How to invest an inheritance

We consider the different ways to get the most from a lump sum of money



**G**etting an unexpected inheritance can provide a valuable boost to your finances – but how do you work out what to do with the windfall?

The average inheritance received is around £11,000, according to figures from the Office for National Statistics, but some people get larger, potentially life-changing sums. Often this is money that people haven't planned on receiving, so it can be tempting to splurge on it, but what's the best course of action?

## TO SPLURGE OR SAVE?

The first thing people think of when they picture a lottery win is usually splurging on a holiday, a new house or something fun for the family. While an inheritance is unlikely to be as large as a lottery win, it can be tempting to see it as bonus money and spend it.

There's nothing wrong with treating yourself with some

of the cash. You could allow yourself to spend a proportion of it on something frivolous or buy something you've wanted for ages. Taking out 10% to treat yourself or the family could work well, and by ring-fencing this as 'fun money' you're less likely to gradually spend a big portion of the inheritance.

## DEAL WITH THE BORING STUFF

Before you think about investing or saving any of the money it's worth paying off any high-cost debt. Lots of people dream of paying off their mortgage with a windfall, and that could be a good use for the money, but you need to make sure you pay off pricier debt first.

Check what interest rate you're paying on your mortgage and then look at any other debt you have and whether it's costing you more. Think about credit cards, overdrafts, personal loans or store cards you might have and

look to pay those off before you tackle the mortgage.

The next step is to check that your emergency cash is sufficiently topped up. Usually it's good to have between three and six months of your outgoings [set aside in easily-accessible cash](#).

## INVEST FOR THE FUTURE

If you are already debt-free and have enough cash in reserve, and you think you can earn more by investing the money than by paying off the mortgage, then you could look to save the money for the future.

Make sure you have a saving goal before you decide where to invest it, as this will help determine what you invest in and how much risk you're willing to take.

If you've received the windfall when you're younger getting on the property ladder might be your target. The average first-time buyer deposit is now

£50,000, meaning it's a high hurdle to reach – but even a £10,000 inheritance would be a valuable contribution.

**Using a Lifetime ISA** is the best idea if you're certain you want to buy a home, as anyone eligible for this wrapper will get a 25% Government bonus on top of contributions, up to £1,000 a year.

You can only pay in £4,000 a year, meaning that you'd need to put any remaining money into a normal stocks and shares ISA and then move it across over the following tax years.

If you had a £10,000 inheritance – and assuming you don't make any further contributions and it grows at 5% a year after fees – with the Government bonus you'd end up with almost £20,000 after 10 years.

### BOOST YOUR RETIREMENT SAVINGS

Another option is to put some or all of the money into your pension. For younger people this might seem like a crazy idea, as you won't be able to access it for so long, but the effect of compounding means that **money put away very early on will have a long time to grow** until retirement. You'll also be able to invest in more high risk assets.

Using the same £10,000 example and 5% growth, with tax relief it would be worth more than £110,000 after 45 years invested. However, you need to be certain that you won't need to access the money, so it's not a decision to take lightly.

Older people who are nearer retirement will be locking the



money up for a shorter period. They can still benefit from putting the money in a pension and getting Government tax relief on top. Even if you're not earning an income you can still put £2,880 a year into a pension, which will be topped up to £3,600 after tax relief, so you could drip feed your inheritance in.

If you're not interested in buying your first home and your retirement seems too far away, you might want to access the money in the shorter-term or save it for something like a new car, a wedding or to gift to family members in the future.

In this case you're probably better using an ISA, as the money isn't tied up and you can get easy access to it. What you invest in will depend on how long you are putting the money away for, but you can add in more risk if you're investing for longer.

### GIVE IT AWAY

Some people might want to pass on their good fortune to charity. You also claim tax relief if you do give the money away.

Many people with children will consider passing some of the inheritance straight to them,

if they haven't received money directly from the deceased.

If large sums are involved a tax-efficient way is to do a deed of variation on the will, meaning that you effectively change the will so a portion of your inheritance is redirected to them.

All the beneficiaries will need to agree. This means that you aren't gifting the money and so it doesn't have to be counted for inheritance tax purposes should you die within seven years of handing the money over.

### MIX IT UP

Another option is to use a mixture of all of these approaches. You could allocate 10% to your fun money pot, put another 20% in your pension, allocate 50% to an ISA for shorter-term spending and perhaps gift the rest of it between charity and family.

The best thing is to have a plan for the money, make sure you don't just leave it in the bank earning a measly interest rate, and invest it as tax-efficiently as possible.



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

# ‘Is it illegal to recycle pension money to get extra tax relief?’

AJ Bell pension expert Tom Selby explains the rules

*I’ve heard that it’s possible to fall foul of HMRC’s pension recycling rules; can you explain the pitfalls and how to avoid them please?*

**Dean**



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

HMRC has rules in place to stop pension savers getting ‘double bubble’ on their pension tax relief. As you say, this concept is referred to by the taxman as pensions recycling.

The concept is straightforward and probably easiest to explain with an example. Take someone who is 65 years old and has a SIPP pot worth £100,000. He takes out his maximum tax-free cash (£25,000) but then invests it straight back into another pension with a different provider.

As a result, he gets tax relief on the money he pays into that pension (immediately boosting it to £31,250) and can get 25% of that money (i.e. £7,812.50) tax-free as well. He might even invest that tax relief in another SIPP, and so on.

I’ve heard this wheeze described variously as a ‘no brainer’ and ‘too good to be true’ by investors. Sadly, the latter point is correct and HMRC has rules in place to prevent excessive recycling of tax-free cash. If you breach these rules



you could be hit with a 55% unauthorised payment charge.

HMRC will consider recycling of tax-free cash to potentially breach its rules where the tax-free sum (or sums) received over a 12-month period are worth more than £7,500.

The rules kick in where the payment has resulted in a 30% or more increase in contributions to your pension compared to what might normally have been expected.

While this might sound a bit vague, it’s actually a specific condition – HMRC looks at contributions paid in the rest of the tax year after you took your tax-free cash plus up to two more years afterwards. This is then compared with the contributions made during a

similar period before tax-free cash was taken.

You can’t get round this by paying into different pension schemes as HMRC will look at all of your contributions when making its assessment.

Equally, HMRC will penalise you for recycling if you borrow money to pay contributions or pay into your pension out of savings and then use the tax-free lump sum to pay off the loan or top up savings.

Incidentally, concerns over recycling were cited by the Government as the primary reason for introducing the Money Purchase Annual Allowance (currently set at £4,000) for savers who access taxable income from their pensions.

## 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.

# What are adjusted earnings and why do companies use them?

Apparently designed to give a truer picture of a company's health, investors should take them with a pinch of salt



**W**hen companies report their financial figures, often the final figure they want you to see is not the one that simply represents all of their incomings minus their outgoings.

A growing number of firms think if you just take the statutory figures they provide, which usually stick rigidly to industry-recognised accounting standards, it doesn't always give a true reflection of how the business is actually performing.

So often companies will adjust their figures, and push investors' attention in the direction of things like their 'adjusted operating profit', which excludes one-off items and potentially gives investors a truer picture of a company's performance based on its day-to-day activities.

Take **Ocado (OCDO)** as an example. The grocery distribution technology firm technically reported a pre-tax

loss of £142.8m in the 26 weeks to 2 June.

But the figure Ocado wants you to look at is its adjusted earnings before interest, taxation, depreciation and amortisation (EBITDA), which stood at £18.7m.

In this case, it is perfectly reasonable to go on the adjusted EBITDA figure because the overall pre-tax loss figure includes the impact of the fire at its flagship robotic Andover warehouse in February, which cost it £99m.

Therefore, to think that the business was ordinarily making a £142.7m loss in half a year would be wrong. This is a genuine one-off item.

## IGNORING THE BAD STUFF

While adjusted earnings are meant to give a truer picture of a company's health for better or worse, an increasing percentage of firms are conveniently leaving

out the 'worse' bit.

Looking at red flags for earnings in the retail sector, analysts at Liberum call the above 'profit smoothing' and say that when a company adjusts its profit higher year in, year out, and sometimes for the same reason each year, it is a 'clear signal of low earnings quality.'

They add that restructuring costs are a staple adjustment for many companies, 'but there are some observers that question whether restructuring costs should be considered exceptional at all, given the fact that businesses are almost always in a state of flux.'

## REPEAT OFFENDERS

In the retail sector, Liberum analysts highlight **Mothercare (MTC)** as 'by far the worst offender' for adjusted earnings.

In its full-year results for 2019, it made an adjusted loss of £11.6m, compared to a statutory

loss of £87.3m. The year before it reported an adjusted profit of £2.3m, compared to a reported loss of £72.8m.

The company has stripped out significant restructuring costs in its adjusted figures, but Liberum points out that Mothercare has been restructuring for the past three years, and while it would appear that restructuring is nearing a conclusion, no end date has been confirmed.

An American study by Professors Paul Griffin and David Lont suggest the adjusted earnings of some companies in the US can be manipulated, and are also often symmetric with one-time gains regularly included but not one-time losses.

One firm in the UK which has been publicly called out on such an issue is **De La Rue (DLAR)**, the banknote and passport printer which has had a dismal time after it lost a contract to produce the UK's post-Brexit passports, issued a string of profit warnings and is still awaiting £18m owed by the Venezuelan government.

## PUSH BACK

The company enraged one of its shareholders, activist investor Crystal Amber, when it claimed in its full-year results on 30 May that performance had 'broadly met market expectations', with adjusted operating profit rising 6% to £60.1m.

In an update on holdings in its fund, Crystal Amber said: '[De La Rue's] claims did not reflect the reality that the £60m of management-adjusted operating profits included an unexpected £7m benefit from an accounting standard change, and ignored an



<b>Adjusted operating profit</b>	<b>£60.1m</b>
<b>EXCEPTIONAL ITEMS:</b>	
Site relocation and restructuring	(£4.8m)
Loss on disposal of business	(£2.6m)
Acquisition costs	(£0.2m)
Pension costs	(£2.2m)
Venezuela bill provision	(£18.1m)
Amortisation	(£0.7m)
<b>Operating profit</b>	<b>£31.5m</b>

Source: De La Rue

£18m provision charge related to the supply of banknotes to Venezuela.'

It added: 'When we challenged chief executive Martin Sutherland as to why the share price fell so dramatically if market expectations had been broadly met, he replied that: "the analysts had got it wrong".' Going on the International Financial Reporting Standards (IFRS) figure as opposed to the figure adjusted by De La Rue, the company made an operating profit of £31.5m in the year to 30 March.

In Griffin and Lont's study, they found that firms in the US were consistently reporting adjusted earnings only a little above what analysts predicted, but changed tack after people became suspicious.

Now, they claim, some

companies across the pond are using all the accounting tricks to get their earnings as high as possible, so they can't be accused of manipulation.

According to the study, on an earnings per share basis, between 2000 and 2016 a quarter of S&P 500 companies beat analysts' expectations when using adjusted earnings. But that percentage fell to just 10% when using their GAAP (Generally Accepted Accounting Principles) results.

So while adjusted earnings can be legitimate, it's always worth delving deeper into a company's accounts and not just taking their adjusted word for it.



By Yoosof Farah  
Reporter

# Should you snap up the income on offer from retail bonds?

We explain how to get exposure to these fixed income instruments

**I**ncome-seeking investors have had a notoriously difficult time in recent years. As interest rates have remained at rock-bottom and quantitative easing sparked a flood of money into fixed income assets, the yields paid by bonds collapsed.

As a result, investors have been forced to move up the risk scale in order to find an income that beats inflation. Retail bonds may be one way for investors to boost the yield of their portfolio and to diversify their income stream – as long as you do your research.

These are not to be confused with the high-yielding mini-bonds offered by the likes of Chilango, with its 8% Burrito Bond, and Wellesley's Property Mini-Bond. Listed retail bonds are those available through the London Stock Exchange on its Order Book for Retail Bonds (ORB) platform.

## STRINGENT CHECKS APPLIED

Unlike mini-bonds, listed retail bonds are vetted and checked and must meet the stringent rules of the stock exchange in order to be able to list. They must publish a full prospectus, written in clear language so that investors can understand what they are investing in and how they can



expect to be paid, for example.

Elena Chimonides, fixed income specialist at London Stock Exchange, says: 'Retail bonds are more robust than mini-bonds, which are more akin to crowdfunding.'

Retail bonds typically offer a higher income than standard corporate bonds, historically 5% or more. Companies often use ORB to issue smaller tranches of debt than they might be able to with an institutional bond – issues listed on ORB are as small as £11m, for example.

This may appeal to smaller companies, which don't have the need to issue hundreds of millions in debt, as well as to larger and more established firms looking to diversify their investor base.

Firms with retail bonds currently listed on ORB range from private firms such as property management group Places for People and housing group A2D to huge household names including Royal Bank of Scotland and HSBC.

## A STEPPING STONE INTO CAPITAL MARKETS

Chimonides says: 'For some companies it's a first stepping stone into capital markets, for others it's a useful way to diversify their investor base by engaging with a new set of retail investors. Because of that, some firms have come back to issue second or third bonds.'

For an investor, the main appeal of a retail bond is usually the coupon it pays. A retail bond

from Beazley has a coupon of 5.3%, Burford Capital 6%, and Provident Financial 5.2%.

These beat both base rate and inflation, which can be hard to achieve elsewhere. However, as demand for high yields remains strong and bond issues remain in short supply, coupons are not as generous as they used to be.

But there is also the potential for capital gains to be made when investing in retail bonds. The prices of these assets move in line with supply and demand, and investors are free to trade listed retail bonds on the secondary market at any time – as long as they can find a buyer or seller.

Popular bonds can see their price rise above par value. The Burford Capital issue, for example, currently has an offer price of 107.6p. Those who bought at issue and sold at this price would have made a capital gain of around 8%.

But, just as with any other asset, negative sentiment can drag down the price of retail bonds. An issue by Wasps Finance, which has a coupon of 6.5%, currently has an offer price



**AS WITH ANY INVESTMENT, DOING YOUR HOMEWORK FIRST IS CRUCIAL WHEN CHOOSING RETAIL BONDS. YOU SHOULDN'T GO INTO ANY INVESTMENT BLIND, YOU NEED TO DO THE RESEARCH**

EXAMPLES OF RETAIL BONDS				
BOND NAME	CODE	ISSUE DATE	MATURITY DATE	CURRENT YIELD
BURFORD CAPITAL PLC BURFORD 22	BUR1	30-Jul-14	19-Aug-22	6.0%
TESCO PERSONAL FINANCE PLC TESCO PF 5%	TSC5	15-May-12	21-Nov-20	4.9%
SEGRO PLC SEGRO.5.75	52VE	21-Jun-05	20-Jun-35	4.0%
WESSEX WATER SERVICES FINANCE PLC WESSEX W.S.5.75	68OP	16-Oct-03	14-Oct-33	3.9%
GLAXOSMITHKLINE CAPITAL PLC GLAXOSMSC 5.25%	AG99	19-Dec-01	19-Dec-33	3.7%

Source: London Stock Exchange. Data as of 29 July 2019

of 90.4p – a capital loss of nearly 10% for those who bought at par.

The coupon represents what a bond would pay at its par value and movements in price will affect the yield, with a fall in the bond price leading to a higher yield and vice versa.

### DO YOUR HOMEWORK

As with any investment, doing your homework first is crucial when choosing retail bonds. Research the company issuing

the bond, consider why it is making the issue and what it plans to do with the money as well as its financial strength and the likelihood that it will be able to pay its coupon and repay the capital you have invested when the bond matures.

Chimonides says: 'You should look at the financial projections of the company, how they have performed and what they are planning to do in the future in order to gauge the credit story of the issuer. Check what else is out there and how the interest rate on offer compares. You shouldn't go into any investment blind, you need to do the research.'

Investors can buy and sell retail bonds through an investment platform, as they would any other listed entity such as a company share.



By Holly Black



## KEY

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

Accesso (ACSO:AIM)	19
AG Barr (BAG)	18, 20
Allied Minds (ALM)	6
Alphabet	16
Amazon	16
AstraZeneca (AZN)	13
BP (BP.)	9
Cairn Energy (CNE)	18, 21
Centamin (CEY)	12
Centrica (CNA)	9
Cobham (COB)	2
Craneware (CRW:AIM)	18, 22
Crystal Amber (CRS:AIM)	6
De La Rue (DLAR)	38
Diageo (DGE)	13, 27
Eddie Stobart Logistics (ESL:AIM)	6
ETFS Copper (COPA)	31
ETFS Tin (TINM)	31
Eve Sleep (EVE:AIM)	6
Facebook	16
FDM (FDM)	15
Fevertree Drinks (FEVR:AIM)	19, 23
Fidelity China Special Situations (FCSS)	28
Fidelity European Values (FEV)	14
Fuller, Smith & Turner (FSTA)	14
Fundsmith Equity (B41YBW7)	26
GB Group (GBG:AIM)	13
Halma (HLMA)	19
Invesco Bloomberg Commodity (CMOD)	30
Invesco Physical Palladium (SPAP)	31
IP Group (IPO)	6
iShares Bloomberg Roll Select Commodity Swap (ROLL)	31

JPMorgan Chinese (JMC)	28
Judges Scientific (JDG:AIM)	13
Just Eat (JE.)	2, 8
Law Debenture (LWDB)	14
LF Woodford Equity Income Fund (BLRZQ62)	6, 26
London Stock Exchange (LSE)	9
Marston's (MARS)	14
Merlin Entertainments (MERL)	2
Microsoft	17
Mothercare (MTC)	37
Netflix	16
NewRiver REIT (NRR)	6
NMC Health (NMC)	19
Non-Standard Finance (NSF)	6
Ocado (OCDO)	37



Provident Financial (PFG)	6
Reckitt Benckiser (RB.)	9, 27
Sage (SGE)	27
Sirius Minerals (SXX)	19, 24
Smith & Nephew (SN.)	27
Snap	17
Softcat (SCT)	10
Sopheon (SPE:AIM)	15
Sophos (SOPH)	10
Sports Direct (SPD)	9
SThree (STHR)	14
Stobart Group (STOB)	6
Twitter	17
UBS ETF CMCI Composite (UC15)	31
Unilever (ULVR)	27
Vodafone (VOD)	7
WisdomTree Enhanced Commodity (WC0G)	31
Woodford Patient Capital Trust (WPCT)	6

# KEY ANNOUNCEMENTS OVER THE NEXT WEEK

## Full-year results

**5 August:** Dialight. **8 August:** Hargreaves Lansdown.

## Half-year results

**2 August:** Airea, BT, Essentra, International Consolidated Airlines, Millennium & Copthorne, RBS.  
**5 August:** BBA Aviation, HSBC, Senior. **6 August:** T Clarke, Domino's Pizza, Genel Energy, InterContinental, IWG, Meggitt, Rotork, SDL, Synthomer, TP ICAP, Zotefoams. **7 August:** Acacia Mining, Hill & Smith, Legal & General, Morgan Sindall, PageGroup, Phoenix, Standard Life Aberdeen, Spirax-Sarco, Ultra Electronics. **8 August:** Arrow Global, Aviva, Tritax Big Box REIT, Coca-Cola HBC, Derwent, Funding Circle, Hastings

## Trading statements

**2 August:** Pets at Home. **7 August:** UDG Healthcare. **8 August:** AA.

## WHO WE ARE

<b>EDITOR:</b> Daniel Coatsworth @Dan_Coatsworth	<b>DEPUTY EDITOR:</b> Tom Sieber @SharesMagTom	<b>NEWS EDITOR:</b> Steven Frazer @SharesMagSteve
<b>FUNDS AND INVESTMENT TRUSTS EDITOR:</b> James Crux @SharesMagJames	<b>SENIOR REPORTERS:</b> Martin Gamble  Ian Conway @SharesMagIan	<b>CONTRIBUTORS</b> Russ Mould Tom Selby Laura Suter Holly Black
	<b>REPORTER:</b> Yoosof Farah @YoosofShares	

**ADVERTISING**  
Senior Sales Executive  
Nick Frankland  
020 7378 4592  
nick.frankland@sharesmagazine.co.uk

**CONTACT US:**  
support@sharesmagazine.co.uk

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**PRODUCTION**  
Head of Design  
Darren Rapley  
Designer  
Matt Ely

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