cityconfidential

sorting the bulls from the bears

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Should you be a ZOO keeper?

AIM-listed ZOO Digital (55.5p) joined the market in 2001 when Zoo Media Corporation was acquired by Kazoo3D. Progress has been slower than shareholders would have hoped over the last couple of decades but plenty of water has passed under the bridge since the dot-com boom at the turn of the millennium. Looking ahead, prospects for the business look very interesting and although the shares will probably never retest the historic highs they once reached, there is room for them to jump from the current level.

The company provides cloud-based localisation and digital distribution services for the global entertainment industry. Its services allow TV and movie content to be subtitled and dubbed in any language then prepared for sale with all major online retailers. ZOO Digital has an impressive client list which includes major Hollywood studios, global broadcasters and independent distributors.

In the year ended 31 March 2020 revenue rose modestly to US$29.8m (2019: US$28.8m) but adjusted EBITDA was US$2.1m, up from US$0.4m a year earlier. The level of profits was helped by a higher mix of strong gross margin sales. Adjusted earnings per share were 0.71c in the last financial year and this figure is forecast to almost double to 1.31c this year, then 2.48c next year. The company needs to generate greater levels of profitability in order to justify a higher share price but the potential for significant growth in profits is clear.

Interim results are due to be released in early November and these could create some interest in the company. Sales growth of roughly 10% is forecast for the current year as a whole, which means that the company will need to demonstrate that this is achievable based on performance in the first half. There is, of course, a chance that current forecasts could prove to be too conservative. The shares carry a high level of risk but we believe that a SPECULATIVE BUY rating is deserved.

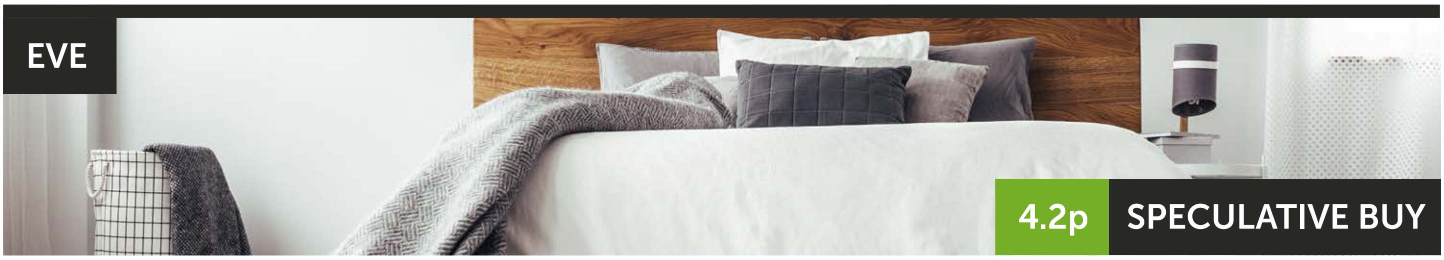
Meggitt weathering the storm

Although it goes without saying that trading conditions for Meggitt (305.9p) remain very difficult, the company is managing to cope with the challenges it is facing. The share price has arguably fallen too far, having lost around half of its value since the turn of the year. Those buying in now need to take a long term view and it is likely to be several years before sales return to 2019 levels. Nevertheless, this is already factored into the equation and any positive news could see the company's valuation recover from what is a low level by historical standards.

Meggitt is a leading engineering company which specialises in high performance components and sub-systems for the aerospace, defence and selected energy markets. Current circumstances mean that the workforce has been reduced by around 18% this year. There have been other cost savings, which have been better than originally estimated, but some planned inventory reduction has been pushed back to 2021.

Interim results covering the six months ended 30 June 2020 were released in September. Orders were £882m (2019: £1,193m) and revenue was £917m (2019: £1,071m). Underlying profit before tax was £86m versus £145m a year earlier and earnings per share on the same basis were 8.7p, down from 14.7p. No interim dividend was declared but on a more positive note net debt was £1,000m at the period end versus £1,124m a year earlier.

We believe that those buying in at around the 300p level should benefit from recovery in the share price over the long term. The nature of the business means that it has been hit by weakness in the end markets it supplies and as the world moves closer to normality, sales should also pick up again. Even in the meantime, the company is paying down debt and dividend payments are forecast to resume in 2021. Analysts are cautious given the ongoing uncertainty and although this is understandable, fears over a slow recovery in fortunes are priced in. On balance we rate the shares as a LONG TERM BUY.



eve Sleep

SECTOR – AIM – HOUSEHOLD GOODS AND HOME CONSTRUCTION

Although the company was only founded in 2015, eve Sleep has had a relatively eventful existence so far. It joined AIM in May 2017 with a placing priced at 101p per share. Less than a year earlier Neil Woodford had taken a significant stake in the business for the funds under his management and this year Link sold the remaining part of this holding at just over 1p per share. Long term holders are still sitting on huge losses but the share price has rallied strongly since March and the scale of the investment in the business so far suggests that there is a credible base from which value can now be built for shareholders.

The company describes itself as a direct-to-customer sleep wellness brand, having made additions to the mattresses which it originally offered. It operates in the UK, Ireland and France. In 2018 the company's strategy of territorial expansion was reversed and achieving profitability became the main focus of an updated strategy. Every aspect of the business has been re-evaluated and the product range has broadened to build credibility in the wider sleep wellness space. The customer journey has been upgraded and marketing now has a focus on greater effectiveness and efficiency. The cost base has also been adjusted to an appropriate level.

The company entered 2020 in good shape, having already completed the bulk of the restructuring and repositioning it had planned. This included a significant round of cost savings towards the end of 2019. This turned out to be fortunate timing as it enabled the business to adapt quickly and effectively to the impact of the Covid-19 pandemic. The supply chain coped well and was supported by taking on some additional stock of key lines in advance of the lockdown. The shift to home working had no noticeable impact on productivity and there was no need to furlough staff.

Results for the six months ended 30 June 2020 were released on 15 September. Overall performance was strong with revenues of £12.2m (2019: £12.9m). Revenues for the UK and Ireland for the period were £9.9m, marginally below sales in the first half of 2019 but marketing investment was 44% lower year-on-year. The contribution from non-mattress sales was steady at 22%, reflecting the decision in the period to focus investment on mattresses. French revenues for the period were £2.4m (2019: £2.8m), after marketing investment which was 77% lower than the previous year. The French market experienced the same broad trading trends during the period as the UK and Ireland. The acceleration in sales post lockdown in France has not been as marked as the UK, mainly due to the business being at an earlier stage in the development of its brand and customer experience.

There was an 86% reduction in underlying EBITDA losses to £0.8m (2019: £5.9m), which as with revenue was ahead of expectations. Trading patterns within the period fluctuated more than usual, with solid trading in the first two months, followed by a dip in March as the countries the company operates in entered lockdown. Recovery in all markets started in early April and strengthened in May and June, with the UK accelerating significantly ahead of expectations. This was helped by a strong homewares market, effective and efficient marketing and tight cost control. Sales of premium mattresses and bedframes were strong, representing 38% of volume sales for the period. This was backed up by wider sales across toppers, pillows and duvets, resulting in 25% year-on-year revenue growth in the second quarter. The second quarter represented the company's first ever break even EBITDA quarter at constant currency.

The greater focus on profitability saw the gross margin in the UK and Ireland increase by 250 basis points to 56.6% as the company improved product margins, tightened cost control and improved stock management. The French business made good progress in the period with the gross margin increasing 660 basis points year-on-year to 51.6% and the marketing contribution improved from a loss of £1.2m in the first half of 2019 to a profit of £0.3m in the first half of 2020.

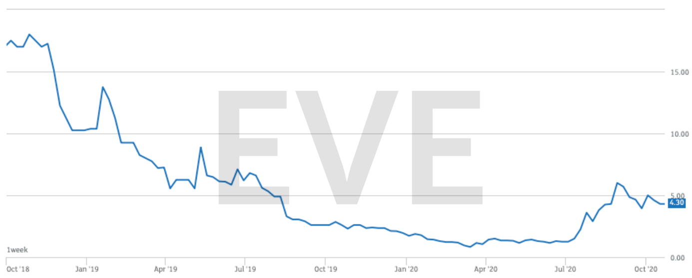
The strength of trading was also reflected in the net cash position of the business, which as at 30 June 2020 stood at £9.2m. The cash balance was inflated by £0.5m of tax payments, which as part of the Government's Covid-19 support package for companies fall due after the period end. Stripping this out the company achieved an underlying positive net cashflow of £0.7m in the period.

The company expects to benefit from further product launches and new partnerships in the second half of the year. Its increasingly strong brand positioning around broader sleep wellness has enabled the company to develop a new 'well slept' range of gifting products exclusively available in Boots stores and online. The new product range will be stocked in 446 stores across the UK and Ireland and Boots online. A weighted blanket and additional bedroom furniture and bedding will be added. In France, the growing popularity of the brand has led to new partnerships with the bedroom and bathroom specialist retailer Olivier Desforges and a live trial in two Casino supermarkets. Since late May mattresses, bedframes and pillows have been available in Olivier Desforges stores across France and online. Retail partnerships remain an important element of the rebuild strategy.

Wellness has been recognised as a 'mega trend' for a number of years, with consumers expressing an increasing understanding and recognition that sleep is key to overall wellness. There is a growing body of research and evidence which highlights the importance of sleep. Data from Euromonitor estimates that the European sleep market is worth £26bn with the core markets that eve Sleep is focused on being worth £6bn.

There has been increasing willingness on the part of consumers to purchase higher value items online. Euromonitor are predicting that the online furniture market will be the second fastest growing retail category, with online purchase penetration expected to increase by 55% between 2018 and 2023. This forecast was made prior to the impact of Covid-19, which is accelerating the trend towards online purchasing. Although the mattress market remains highly fragmented there has been considerable change in the competitive landscape. Primarily online brands Casper and Leesa have closed their European operations, while many store based competitors have reduced their high street footprints. The company's strategy is to differentiate itself from peers, supporting a broader, more varied product set through building a brand around the wider sleep wellness category.

This may be a share which, hopefully unlike the company's products, causes a few hours of lost sleep at times but there is certainly scope for significant upside from the current level. The level of net cash held is almost equivalent to the market capitalisation and although tens of millions have been spent developing the business so far, this has been an investment in what could ultimately turn out to be a very valuable brand. Recent interim results were intriguing and given the manner in which Covid-19 has affected the retail sector, eve Sleep could be a beneficiary of more online shopping. At the current price we rate the shares as a SPECULATIVE BUY.



Share Price: 4.2p
Market Capitalisation: £11.4m
2019/20 Share Price Range: 6.42p/0.83p
Website: investor.evesleep.co.uk

Year Ending 31 December	Turnover (£m)	Adjusted Pre-Tax Profit (£m)	Adjusted Earnings Per Share (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2017	34.8	(19.0)	(16.2)	-	-	-
2018	29.4	(20.3)	(14.5)	-	-	-
2019	23.9	(12.5)	(4.9)	-	-	-

Aggressive Growth Portfolio VII

The last month has seen an excellent performance from the portfolio, which has risen in value by 6.0%, thus significantly outperforming both of the benchmark indices. A number of companies contributed to this performance including Vertu Motors, Drax Group and Investec.

Companies in the portfolio that have made announcements during the month are Character Group, Caretech, Premier Miton and Vertu Motors and these have been covered on the website.

Following the strong run in the share price of Vertu Motors we have decided to top-slice the holding and have therefore sold 3,000 shares at 31.15p for net proceeds of £925. This has realised a gain of £244 and left the portfolio with a holding of 15,000 shares. We have also decided to cut our losses on PPE Hotel Group selling the holding of 350 shares at 1000p to realise net proceeds of £3,465 and a loss of £940. With new lockdown restrictions being imposed in parts of the country we do not believe the shares are likely to make any progress in the short-term and a sale seems prudent.

We have decided to increase the stop-loss limit on three holdings with that of Caretech rising to 375p, Vertu Motors motoring to 25p and Drax Group increasing to 250p.

A dividend of £112 has been received from Drax Group and after purchasing shares in the two companies featured in this issue there is £5,838 left on deposit.

Performance summary

	20 October 2020	22 September 2020	Gain/(Loss) %
Portfolio Value	£67,222	£63,420	6.0
FTSE 100 Share Index	5,889.22	5,829.46	1.0
FTSE All Share Index	3,315.73	3,249.29	2.0

	Security	Buying Price (p)	Total Cost (£)	Current Price (p)	Value (£)	Stop-Loss Limit (p)
1,200	Character Group	255	3,091	310	3,720	185
1,750	Sainsbury (J)	192	3,417	204.1	3,572	145
5,000	UP Global Sourcing*	54.1	3,844	100	5,000	80
5,000	Alliance Pharma	73.9	3,732	75.4	3,770	57
1,650	Bloomsbury Publishing	223	3,734	215	3,548	185
1,000	Caretech	395	3,989	458	4,580	375
3,750	Premier Miton	107.5	4,071	106.5	3,994	75
1,650	Drax Group	232.8	3,898	301.6	4,976	250
15,000	Vertu Motors*	22.5	3,408	31.15	4,673	25
1,400	DS Smith	282.8	4,019	306.9	4,297	240
2,350	Investec	146.6	3,496	154.65	3,634	120
4,000	Johnson Service Group	95.9	3,893	94.7	3,788	70
6,750	Finsbury Food	56.9	3,879	52.5	3,544	45
100,000	eve Sleep	4.2	4,242	4.2	4,200	3.4
1,325	HSBC	308.55	4,149	308.55	4,088	265
£5,838	Cash	-	-		5,838	
				TOTAL	**£67,222**	

Start date: 2 January 2018 with £50,000. Cash includes dividends received of £4,141 *after profit taking.

HSBA

308.55p

HSBC HOLDINGS

SECTOR – BANKS

Since the turn of the year HSBC has seen its share price slide, broadly halving in value and reaching a level which has not been seen since the mid-1990s. The shares now stand at a steep discount to their net asset value, which is unsurprising given that banks are now required to maintain strong balance sheets for regulatory purposes. We feel that there is a great deal of negative sentiment impacting upon the value of HSBC and at some point soon the share price will surely rally.

HSBC is currently divided into three businesses. Wealth and Personal Banking helps customers look after their day-to-day finances as well as managing, protecting and growing their wealth. Commercial Banking works with domestic and international businesses around the world. Global Banking and Market provides a comprehensive range of financial services and products to corporates, governments and institutions.

Interim results covering the six months ended 30 June 2020 were released in August. This represented a very unusual period, not just for the company but for the global economy. Reported profit after tax was US$3.1bn versus US$9.9bn a year earlier. Basic earnings per share were US$0.10 versus US$0.42 in the same period in 2019. No interim dividend was declared.

Although the company made a good start to the year in January and February, the Covid-19 pandemic had an obvious impact and this was compounded by falling interest rates. Reported revenue fell by 9% but Asia businesses were resilient and Global Markets grew revenue due to higher levels of client activity. The company is now looking to the future and recovery from the period of disruption which has been faced. It is clear that there is plenty of hard work ahead but HSBC is relatively well positioned and the adversity currently faced by some customers could create other opportunities.

If the company can return to the levels of profits it has generated prior to the last couple of years and maintain this performance consistently then the current entry level will prove to be extremely good value. The dividend could also be rebuilt relatively quickly and the income from the shares alone, assuming this is covered by earnings, should be a good reason to hold in the coming years. The banking sector as a whole is no longer the safe haven it was once thought to be but this looks to be a very good opportunity to buy into a high quality business at a bargain basement price. BUY.

Share Price: 308.55p
Market Capitalisation: £62.8bn
2019/20 Share Price Range: 680.6p/283.35p
Website: www.hsbc.com/investors

Year Ending 31 December	Turnover (£m)	Adjusted Pre-Tax Profit (£m)	Adjusted Earnings Per Share (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2018	41,690	16,420	52.0	5.9	39.5	12.8
2019	43,487	17,219	38.7	8.0	39.5	12.8
2020E	38,889	7,075	18.6	16.6	6.6	2.1

*£1 = US $1.29

News Highlights

As subscribers will know, we update the website with news that involves the companies that we follow, but we have highlighted what we regard as the most important news here.

Character Group (CCT) – 310p

The group has issued a positive trading update for the financial year ending 31 August 2020 despite the adverse effects of coronavirus which resulted in the lockdown of much of the country. Trading at the group has continued at satisfactory levels with demand for the group's exciting and innovative products proving resilient. The company therefore expects that the second half of the year will prove profitable and the level of profit will be at least equal to the first half when pre-tax profits were £2.5m. This resulted in earnings per share of 9.6p and the company had net cash of £16.8m at the end of February. The statement implies that full year profits will therefore be in excess of £5m for earnings per share of at least 20p. The company has maintained its strong balance sheet during this period which will also stand it in good stead. The company expects the positive trading to continue up to Christmas and into 2021. The shares have held up well in the market turmoil seen over recent weeks and they remain a FIRM HOLD.

Journeo (JNEO) – 51.5p

AIM-listed Journeo, which supplies CCTV systems to the transport industry, has received an order worth £0.6m from Wrightbus to supply on-board safety and security systems for new buses being manufactured between November 2020 and March 2022. Most of the revenue from the contract will come into the 2021 financial year. This is the first order from the Northern Ireland based Wrightbus since the latter was bought out of administration last year by Jo Bamford, the son of JCB chairman Lord Bamford. Thus it is encouraging that the long standing relationship with the company looks set to continue. Although the order may only be small, it should be remembered that in 2019 total revenues were only £11.4m. This contract is clearly encouraging and the shares have moved up from the recent lows as a result – we believe the share price could recover to its high of the year of 73.5p and therefore rate the shares a BUY.

Vertu Motors (VTU) – 31.15p

The motor dealership group, which is the fifth largest automotive retailer in the UK, has announced its interim results for the six month period to 31 August and these have revealed revenues of £1.12bn with adjusted pre-tax profit emerging at £4.7m. This reflects a profit of £19.0m in the second quarter which more than made up for the loss of £14.3m reported in the first quarter as the effect of the lockdown took hold. During this period showrooms were closed for 10 weeks and so there was considerable pent-up demand for motor vehicles when these re-opened and the group has benefited accordingly. Strong cash flow during the period led to net cash balances of £36.5m at the end of the period. The month of September produced a record trading performance for the group and this strong level of trading looks set to continue. Although the share price has moved up recently the shares still look ATTRACTIVE.

Caretech (CTH) – 458p

The specialist social care and education services group has announced a positive trading statement for the year to 30 September with trading continuing to be robust with results for the year coming in ahead of expectations. Revenues for the year are expected to be higher than the previous year with trading being particularly strong in the latter part of the year in the group's subsidiary in the UAE. Strong cash flow resulted in a decline in net debt to £268.9m from £287,4m in March despite the costs of the UAE acquisition and the integration costs of the Cambian acquisition which continues to perform in line with expectations. The company has recently taken a majority stake in Smartbox Assistive Technology Limited, a company providing software and hardware allowing disabled people without speech to have a voice. The company will produce its annual results on 3 December but we expect the group to make continued progress going forward and rate the shares a LONG TERM BUY.

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VAT No: GB 607 1818 48

Independent Financial Publications, 1 Skipton Road, Ilkley, West Yorkshire, LS29 9EH

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