

cityconfidential

sorting the bulls from the bears

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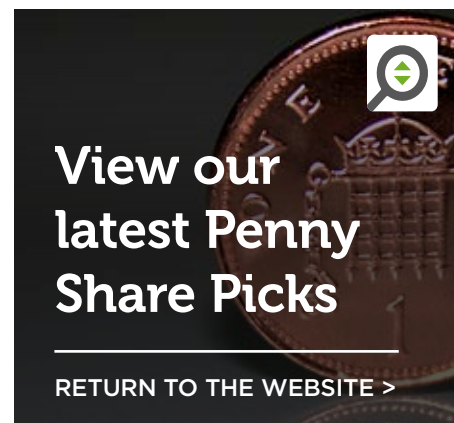
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Mail Shot?

Unfortunately for those already invested, shares in **Royal Mail (273.4p)** have failed to deliver recently. In fact they have broadly halved in value since the start of 2022. However, the company still has plenty going for it and although it has various issues to contend with, it is arguably far better placed than the current share price suggests.

Results for the year ended 27 March 2022 were released in May. Revenue edged up from £12,638m to £12,712m and adjusted profit before tax was £707m (2021: £664m). The latter translated into adjusted basic earnings per share of 60.0p, up from 52.1p a year earlier. A final dividend of 13.3p per share was declared (2021: 10.0p) and this alone represents 4.9% of the current share price.

Royal Mail's strategy is to transform the business into a more efficient parcels-focused operation. In the last financial year GLS continued to execute its Accelerate strategy, building on gains achieved during the previous year and generating around €500m of pre-IFRS 16 free cash flow in the first two years versus a target of €1bn by 2024-25. The trading environment is uncertain for both Royal Mail and GLS. All markets addressed have been impacted by the more challenging global economy, with high levels of inflation and expectations of lower future economic growth. Positive revenue impacts from Covid-19, such as growth in online retail and test kits, have faded but additional Covid-related cost and inefficiency in the company's networks has remained.

It is in some ways surprising that Royal Mail's share price has fluctuated as much as it has since it joined the market in 2013. At the time there were serious concerns that the company had been sold off too cheaply by the Government but since then there has been considerable volatility. There are well-documented cost pressures but this is a business which is better positioned to pass on higher input prices than most. Some reports suggest that there could be strike action from workers and as well as a financial impact that would hit sentiment. In some areas the company is effectively still a monopoly and although it is unlikely to be plain sailing in the immediate future there should be better times ahead. **LONG TERM BUY.**



Chunky returns from hidden gem

AIM-listed **Livermore Investments Group (51.5p)** is an interesting proposition. It is certainly a niche player and the nature of the business combined with its small size means that it is relatively unknown. This can create an opportunity to buy into something which others are not considering, particularly if those who do hold lack patience or the ability to retain their holding over the long term. The company has returned significant amounts of cash to shareholders over the last twelve months or so and those willing to accept a high level of risk could also see strong returns moving forwards.

The company's stated investment objective is to generate high current income and

regular cash flows. It has a financial portfolio constructed around fixed income instruments such as Collateralized Loan Obligations (CLOs) and other securities or instruments with exposure to senior secured and usually broadly syndicated US loans. It was established in 1998 and has offices in Cyprus and Zurich.

Results for the year ended 31 December 2021 were released on 30 May. During the year the Net Asset Value per share increased by 13.8% to USD\$1.07 (2020: US\$0.94), which after taking dividend payments into account equated to a total return of 19%. Net profit for the year was US\$24.7m (2020: net profit of US\$0.845m). On 16 April 2021 an interim dividend of US\$0.0488 per share was paid and during the calendar

year the company distributed a net US\$6.057m to shareholders via share buybacks. An interim dividend of US\$0.145 per share was paid in February. The CLO portfolio and warehouse generated US\$27.3m in cash distributions and a provided a total return of US\$30.6m in 2021.

A key risk to consider is that two shareholders have a combined stake of almost 90%, which puts them in a powerful position. However, the shares trade at a significant discount to the NAV and although total returns are likely to fluctuate the potential for high returns is clear. On balance the shares are a **SPECULATIVE BUY.**

HFD

148.8p BUY FOR RECOVERY

Halfords Group

SECTOR – RETAILERS

Shares in **Halfords Group** have fallen significantly over the last twelve months. Long term holders have seen this situation several times before and strong rallies have followed. History will not necessarily repeat itself, earnings will almost certainly decline in the current financial year and there are plenty of challenges ahead. Bad news is priced in though and at some point the tide of negative sentiment will surely turn. Taking a contrarian view is slightly brave given the macroeconomic outlook for the UK but the shares have dropped a long way and a bounce must be on the horizon.

Founded in the late 1800s, Halfords Group is the leading provider of cycling and motoring products and services in the UK. In terms of motoring, the company addresses two distinct areas of the market, Car Parts, Accessories, Consumables and Technology as well as Car Servicing and Aftercare. There is no equivalent competitor in Car Parts, Accessories, Consumables and Technology in physical locations as many specialists and generalists operate exclusively online. In terms of Car Servicing and Aftercare, there are over 30,000 garages in the UK. Of these around two-thirds are small independents.

The UK cycling market is highly fragmented, with an estimated 2,500 bike shops. The majority of these are independently owned. Halfords Group is the market leader, with strong brand awareness in bicycles, parts, accessories and clothing. The company monitors market trends to keep up with customer demand. For example, it was the first major stockist of E-scooters and is leading the market. Although it has a smaller market share in performance cycling than mainstream, this is also seen as being a growth area.

Results for the 52 weeks ended 1 April 2022 were released on 16 June. Group revenue was £1,369.6m, which included Retail revenues of £1,001.6m and Autocentres revenue of £368.0m. This compared to revenue of £1,142.4m two years earlier, when Retail revenue was £950.6m and Autocentres revenue £191.8m. Retail revenue grew 5.4% versus two years earlier but was down 3.7% versus the prior year, mainly due to a normalised cycling market after strong demand during the early months of the Covid-19 pandemic. Both Motoring and Cycling revenue grew versus two years earlier but compared to one year earlier Motoring recovered significantly and Cycling declined. Autocentres revenue almost doubled over two years and grew 45.7% versus the prior year, reflecting organic growth and acquisitions.

Group Underlying EBITDA was £207.1m (2020: £188.6m; 2021: £233.0m). Underlying Profit Before Tax for the year was £89.8m (2020: £56.9m; 2021: £99.5m) and after non-underlying items, Group Profit Before Tax was £96.6m (2020: £22.7m; 2021: £64.5m). Underlying basic earnings per share post IFRS 16 were 35.5p (2021: 41.7p) and after non-underlying items the figure was 37.9p (2021: 27.1p). A final dividend of 6.0p per share (2021: 5.0p) was declared. This will be paid on 16 September and the ex-dividend date is 11 August.

Capital investment in the 52 weeks ended 1 April 2022 was £49.2m (2021: £45.3m) with £31.1m of this in Retail and £18.1m in Autocentres. Within Retail, £11.5m (2021: £6.0m) was invested in stores. Additional investments in Retail infrastructure included a £17.9m investment in IT systems, including the continued development of the new Group website. The £18.1m (2021: £22.0m) capital expenditure in Autocentres mainly related to the replacement of garage equipment and replacement of fixtures and fittings. There was also further development of PACE, the digital operating

model which is used in garages. Group inventory held was £222.1m as at the period end versus £143.9m a year earlier. Retail inventory increased to £194.5m (2021: £134.3m) due to normalised stock levels after Covid-19 disruption. Autocentres inventory was £27.6m (2021: £9.6m) with the increase in inventory primarily relating to the acquisition of National and a stock holding of tyres.

Operating Cash Flow was £131.8m (2021: £280.8m), reflecting a working capital outflow of £70.0m, which arose due to the normalisation of inventory levels. After taxation, capital expenditure, net finance costs and lease payments, Free Cash Flow was -£14.9m (2021: £133.2m). Group Net Debt as at the period end was £344.9m (2021: £277.3m).

There is considerable uncertainty over the current financial year. The company noted in its outlook statement within the recent final results announcement that underlying profit before tax is expected to be within the range of £65m to £75m. However, it acknowledged that this year is likely to be difficult to predict. Over the last three years the company has focused more heavily on motoring and in areas where expenditure is a necessity rather than a luxury. Reduced demand, particularly for more discretionary, higher ticket items is likely to impact near term performance though. During the current year the company will continue to invest to improve its customer proposition. The market leadership position in both motoring and cycling, as well as a strong balance sheet, leaves the company in a relatively healthy position.

Halfords Group has rarely attracted a premium rating in the past and is unlikely to become fashionable with investors any time soon. Even so, the valuation placed on the company looks too low. Particularly looking at the p/e ratio on which the shares stand, the shares look very cheap. A yield of 6.0% is also difficult to come by and suggests significant doubt that forecast financial performance will be achieved. Disruption caused by Covid-19 clearly provided a boost in the recent past but looking further ahead, prospects should not be as bleak as the current share price indicates. We believe that the shares have a very good chance of rebounding to at least the 200p level at some point this year and this would represent an excellent return of 34%. A trading update for the period ending 19 August 2022 is due to be released on 7 September. With little room for sentiment towards the stock to become any more bearish before then, we suggest that now is an opportune time for readers to **BUY FOR RECOVERY**.



	Year Ending 31 March	Turnover (£m)	Adjusted Pre-Tax Profit (£m)	Adjusted Earnings Per Share (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
Share Price: 148.8p	2022	1,370	89.8	35.5	4.2	9.0	6.0
Market Capitalisation: £336m	2023 (est)	1,520	75.4	27.6	5.4	9.3	6.2
2021/22 Share Price Range: 435p/142.8p	2024 (est)	1,552	86.3	30.4	4.9	10.5	7.1
Website: www.halfordscompany.com							



Aggressive Growth Portfolio VIII

After trading in a relatively narrow range for some weeks, fears of higher interest rates and rising inflation have caused a sell-off in equities which has seen all the major indices fall back. Although the portfolio has not escaped the sell off, it is pleasing to report that the decline in value over the last five weeks has been considerably less than the falls seen in the benchmark indices as can be seen from the table below.

As happened last month, we have lost two companies from the Portfolio with shares in **Topps Tiles** falling through the stop-loss limit of 48p. The sale of 4,250 shares at that price resulted in net proceeds of £2,020 and a

loss of £672. Similarly, the sale of 725 **James Fisher** at the stop-loss limit of 340p generated net proceeds of £2,440 and a loss of £673. It was not all bad news for the portfolio, however, with shares in **Melrose Industries** rising by almost 33% and those of **Serco** increasing in value by 15%.

Several companies in the portfolio have made announcements during the month and these are **Hargreaves Services**, **Serco Group**, **QinetiQ**, **Synectics**, **NWF Group** and **Melrose Industries**.

Dividends were received during the month from **Luceco** (£70), **Serco Group** (£42) and **Melrose Industries** (£28). Although shares in **Luceco** were sold last month we were still entitled to the dividend and following the purchase of shares in both companies featured in this issue, there is just £246 left on deposit pending investment.

Performance summary

	21 June 2022	17 May 2022	Gain/(Loss) %
Portfolio Value	£55,553	£55,945	(0.7)
FTSE 100 Share Index	7,152.05	7,518.35	(4.9)
FTSE All Share Index	3,943.98	4,149.88	(5.0)
FTSE AIM All Share Index	898.40	961.72	(6.6)

	Security	Buying Price (p)	Total Cost (£)	Current Price (p)	Value (£)	Stop-Loss Limit (p)
500	Hargreaves Services*	264	1,334	520	2,600	280
2,600	Serco Group	125.4	3,309	172.3	4,480	105
2,350	Senior	149.3	3,562	124.2	2,919	115
12,000	Renold	25.1	3,042	25.5	3,060	20
4,500	GetBusy	66	3,000	58.5	2,633	50
1,000	QinetiQ	282.4	2,866	352.8	3,528	220
725	Redde Northgate	397	2,921	345.5	2,505	325
14,000	Appreciate Group	23	3,252	26.35	3,689	18
2,800	Alliance Pharma	110.4	3,122	109	3,052	85
3,125	Brighton Pier	83.5	2,635	86.5	2,703	65
2,825	Synectics	92.5	2,639	105	2,966	75
4,500	Finsbury Food	75.5	3,432	69.5	3,128	58
1,500	NWF Group	209	3,166	221	3,315	165
3,500	SigmaRoc	78.5	2,774	59	2,065	55
2,750	Melrose Industries	117.65	3,283	156.25	4,297	95
625	Portmeirion Group	475	2,999	420	2,625	350
2,000	Halfords Group	148.8	3,021	148.8	2,976	120
1,500	Devro	184.4	2,807	184.4	2,766	150
£246	Cash	-	-	-	246	-
TOTAL					£55,553	

Start date: 19 January 2021 with £50,000. Cash includes dividends received of £1,741 *after part disposal.

DVO

DEVRO

184.4p

SECTOR – FOOD PRODUCERS

Given current market conditions, considering a steady, durable business such as **Devro** is a sensible move. The fact that the shares are trading well below their year high makes the investment case even more compelling. This leaves the shares looking good value and the yield, which is 5.0% and rising, should offer support. Although growth opportunities appear limited, a higher rating would be no real surprise in the coming months and forecasts should also be conservative.

Devro is a leading supplier of collagen casings for food. These casings are used by customers in the production of sausages and other meat products. Collagen is a naturally occurring polymer which is converted into gel, tubular casing and film at the company's manufacturing sites in the UK, US, Netherlands, China, Czech Republic and Australia. Devro was listed on the London Stock Exchange in June 1993.

On 28 April the company released a trading update to coincide with its

Annual General Meeting. High single digit constant currency revenue growth was generated in Q1 versus the prior year. This was driven by a combination of volume, price and mix. North America and Continental Europe saw the strongest volume growth in the quarter. Despite cost pressures the company noted that it continued to achieve targeted price increases and maintain tight cost management. Full year profits will be more second half weighted than they are normally but the company expects good progress to continue through the rest of the year. Net debt at the end of March was around £100m. Strong cash generation for the full year is anticipated with further progress on reducing net debt.

The shares stand on a multiple of just over 10 times both historic and prospective earnings. For a business of Devro's quality this is undemanding. Under current market conditions the rating appears to be on the low side and leaves scope for meaningful capital growth, something which could be increasingly difficult to find elsewhere. Although there are cost pressures to contend with, demand for the company's products should remain relatively stable even if consumers cut back further on overall spending. On balance the current share price offers an attractive entry point and we put forward a **BUY** rating.

	Year Ending 31 December	Turnover (£m)	Adjusted Pre-Tax Profit (£m)	Adjusted Earnings Per Share (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
Share Price: 184.4p	2021	252	36.9	18.1	10.2	9.3	5.0
Market Capitalisation: £309m	2022 (est)	266	39.8	18.1	10.2	9.6	5.2
2021/22 Share Price Range: 228.5p/155p	2023 (est)	275	42.4	19.2	9.6	10.0	5.4
Website: www.devro.com							

News Highlights

Serco Group



172.3p BUY

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.

Serco Group – 172.3p

An unscheduled trading statement has been released by the outsourcing group Serco following stronger than expected trading in the first four months of 2022. Despite the end of the UK Test and Trace programme in April, which will reduce revenues in the first half of the year by some £220m, the group has been able to replace this revenue with other sales meaning that first half group revenues will be similar to last year at £2bn. This has resulted in the group predicting that underlying trading profits will be some £30m ahead of previous guidance at £225m with pre-tax profits therefore forecast to be £200m for the year. This would generate earnings per share of 12.4p. This would put the shares on a prospective p/e ratio of around 13.9x which is not expensive given the growth prospects at the group. Although there is not much by way of dividend, with this forecast to be around 2.7p per share for the year, net debt is also expected to fall to £200m by the end of the year. We maintain our recommendation of **BUY**.

Melrose Industries – 156.25p

The company has announced the disposal of Ergotron, the last business it acquired following the purchase of Nortek in 2016. This has been sold for total consideration of around \$650m (£520m) in cash. Following the disposal of all the businesses in Nortek, Melrose has more than doubled its initial investment thus demonstrating once again the success of its strategy. Following this sale, the company has announced a share buyback programme which will see up to 437.2m shares bought back for total consideration of £500m. Yet again, Melrose has succeeded in buying, improving and then selling a group of businesses for the benefit of shareholders. Although we only tipped the shares last month at 117.65p, we believe they have further to go. **BUY**.

Coral Products – 15.65p

The manufacturer of plastic products has announced the acquisition of Alma Products Limited, a company based in Runcorn which will reinforce the group's focus on niche, specialist operators in the plastics sector. Alma can operate across a range of sectors and the acquisition will broaden the group's product and manufacturing offering thus expanding the market opportunities that are available to the group. The consideration for the purchase is £1.5m in cash with an earn out of up to a maximum of another £1.5m. The group has also issued a trading update, confirming that group revenues for the year to 30 April are expected to be at least £14.4m, an increase of 35% over the previous year and pre-tax profits are therefore expected to be significantly above market expectations. Cash and cash equivalents at the year-end were £7.4m although the two acquisitions since then will reduce this. The group is proposing a total dividend for the financial year that has just ended of 1.1p per share putting the shares on a yield of 7.0% and a confident statement about prospects for the current year helps to support our belief that the shares have further to go. Continue to **BUY**.

NWF Group – 221p

The specialist distributor of fuel, food and feed has issued a trading statement covering the year ending 31 May 2022 confirming that the results for the year will be at record levels. In addition, cash conversion has been strong with the group ending the year with net cash of around £8m as opposed to having debt a year earlier. The exceptional performance in the year is largely due to the fuels business which has benefited from oil price volatility and shortages of supply. These factors are ongoing although the effect is likely to reduce going forward. Adjusted pre-tax profits for the year just ended are therefore likely to be higher than our previous forecast of £17.0m with £20.0m now on the cards. That would translate into earnings per share of around 32.5p, putting the shares on a low p/e ratio of just 6.8x. However, the new financial year is likely to see profits return to more normal levels with £12.0m forecast for earnings per share of 18.5p. This still leaves the shares on

an attractive rating and if the dividend for the year is raised to 7.7p this would put the shares on a dividend yield of 3.5%. The shares remain a solid investment and we retain our recommendation of **BUY**.

QinetiQ – 352.8p

The science and engineering company which is focused on defence and security markets has announced its results for the year to 31 March 2022. Revenues have increased over the year to £1.32bn (2021: £1.28bn) although underlying pre-tax profits fell to £136m (2021: £150m) and earnings per share declined to 20.6p (2021: 22.1p). However, the dividend was increased to 7.3p (2021: 6.9p) and net cash at the year-end had risen to £225.1m (2021: £164.1m). The group had a record order intake in the year of £1.23bn to take the total order book to £2.8bn and analysts are expecting pre-tax profits to rise to £157m in the current financial year for earnings per share of 23p. This would put the shares on a prospective p/e ratio of 15.3x which is not especially cheap, but with defence spending likely to increase following the conflict in Ukraine we believe this is more than justified. Given the strong balance sheet and the obvious potential for growth at the company we maintain our recommendation of **BUY**.



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