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sorting the bulls from the bears

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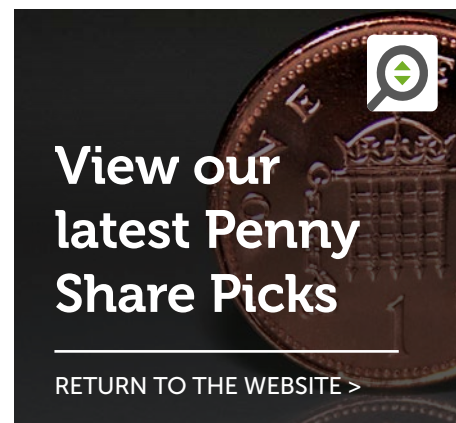
**Babcock International Gp.**

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## On the crest of a Kitwave

Kitwave Group (296p), a delivered wholesale business, has scheduled the announcement of its interim results for the six months ended 30 April for 4 July. The company joined AIM in May 2021 and has delivered strong returns for shareholders since then. Growth has been achieved both organically and through the acquisition of smaller, predominantly family-owned, complementary businesses in the fragmented UK grocery and foodservice wholesale market.

The business was founded in 1987 when a single-site confectionery wholesale business, based in North Shields, was acquired. Kitwave Group now specialises in selling and delivering impulse products, frozen, chilled and fresh

foods, alcohol, groceries and tobacco to approximately 42,000 customers. It has a network of 29 depots to support delivery throughout the UK to a diverse customer base. This includes independent convenience retailers, leisure outlets, vending machine operators, foodservice providers, other wholesalers and leading national retailers.

A trading update was released on 2 May and strong performance across all divisions continued throughout the first half of the current financial year. The seasonality of the business means that there is a weighting towards trading in the second half of the year but results for the full financial year are now set to be slightly ahead of market

expectations at the time. Westcountry Food Holdings Limited, a specialist fresh produce wholesaler, was acquired in December 2022 and is said to be performing in line with management expectations.

There is scope for both organic developments and complementary acquisitions to help drive more growth in the coming years. The market in which it operates is fragmented and a strong platform for growth has clearly been established. The shares have outperformed strongly so far this year but sustained growth is likely in the coming years and there is potential for the rise in the share price to continue on the back of upcoming results. We put forward a **TRADING BUY** recommendation.



## All Systems go!

Shares in Spectra Systems (167.5p) potentially look good value given the nature of the business and the strength of the company's balance sheet. This is an AIM-listed business which has a very interesting niche offering and a proven ability to deliver a significant level of profits.

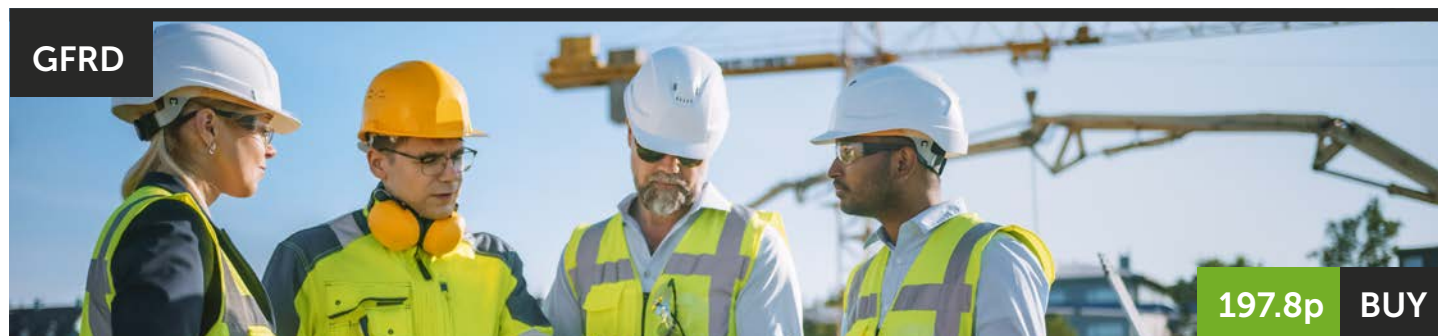
The company is a leader in the provision of security technology including software and advanced materials for use in banknotes, product authentication and gaming. It provides integrated solutions comprised of engineered materials for authentication and hardware and software systems which verify the unique signatures of the authentication materials. Spectra Systems has become a leading player in the currency and document authentication

markets and one of the leading suppliers of high-speed currency authentication sensors. It has developed a system which can remove oils and other contaminants from banknotes in circulation, protecting processing staff from hazardous contaminants and extending the life of banknotes. Other solutions are used for authenticating and tracking consumer branded products such as energy drinks, shampoo, wine, spirits, and tobacco. Security software also provides secure Internal Control Systems to US and international lotteries.

Results for the twelve months ended 31 December 2022 were released in March. Revenue was US\$19.6m (2021: US\$16.6m) and adjusted EBITDA was up 17% to US\$8.1m (2021: US\$6.9m). This translated into adjusted

earnings per share of 14.5c versus 12.0c a year earlier and cash generated from operations was flat at US\$8.0m (2021: US\$8.0m). A dividend of 11.5c per share is due to be paid around 23 June. The company has no debt and held US\$17.5m of cash as at 31 December 2022, up from US\$16.8m a year earlier.

The underlying performance of the business has been sound and there have been efforts to deliver value for shareholders, such as buying back stock. The level of dividend payments is attractive and provides a good incentive for those with a long term investment horizon to invest. The cash held also means that there is a level of downside protection. We therefore rate the shares as a **BUY**.



## Galliford Try - 197.8p

SECTOR - CONSTRUCTION AND MATERIALS

With a trading update scheduled for 11 July, now is an interesting time to consider investing in **Galliford Try**. Earlier this month the company announced that it has reached a settlement relating to a dispute over three contracts with entities owned by a major infrastructure fund. This will enable a special dividend to be paid in late October. There are no guarantees that the trading update next month will be positive but if there is more reassurance on current trading this should see buying interest return, particularly given the added attraction of the special dividend.

The company is a leading construction group which operates as Galliford Try and Morrison Construction. It carries out building and infrastructure works across the UK through several regional offices. This enables a local approach to be applied across a wide range of markets. The work undertaken for both public and private sector clients is well balanced and widespread. There is a focus on areas where the company has core and proven strengths, such as Building, Highways and Environment. Long-term growth and appropriate margins are characteristics in these markets.

Interim results covering the six months ended 31 December 2022 were released in March. During the first half of the year strong performance resulting in increased revenue and divisional operating margin.

Revenue was up 14% to £679.2m versus £594.0m in the same period a year earlier. This reflected disciplined growth in Infrastructure as well as the benefit of a full six months of trading from the nmcn water business which was acquired in Autumn 2021.

Pre-exceptional operating profit before amortisation was 57% higher at £10.8m, up from £6.9m a year earlier, including the profit on disposal of an interest in a joint venture arrangement. The combined divisional operating margin was 2.3%, with slight improvement in both Building and Infrastructure. Building generated profit of £9.3m and an operating margin of 2.3% and Infrastructure generated profit of £6.5m, also with operating margin of 2.3%. Pre-exceptional profit before tax was £11.7m, up from £7.1m in the prior year. Based on pre-exceptional earnings per share of 8.8p and the outlook for the remainder of the financial year, an interim dividend of 3.0p per share was declared.

The company operates with daily net cash, no debt facilities, and no defined benefit pension liabilities so it has no issues in terms of its balance sheet. Average month end cash balances for the first half year were strong at £154m. This is in line with the expectations given recent acquisitions, ongoing investment in cloud-based digital systems as previously disclosed, and around £10m of dividends and capital returns in the half year. Average cash for the full year to 30 June 2023 is expected to be at a similar level. The company also has a PPP asset portfolio of £46.1m, reflecting a blended 7.1% discount rate and generating interest income.

The acquisition of MCS Control Systems in July 2022 and Ham Baker in November 2022 have resulted in an increase in intangible assets of £0.3m and goodwill of £3.8m. The acquisitions further enhance the specialist offering in the Environment business and have increased operational capabilities.

As at 31 December 2022 the order book stood at £3.5bn versus £3.4bn a year earlier, of which 91% is in the public and regulated sectors and 9% is

in the private sector. It is interesting to note that 95% of projected revenue for the current financial year was secured at the time, with 79% already secured for the next financial year.

The outlook statement was also relatively upbeat, with the company noting its strong track record and focus on the public and regulated sectors. Recent project wins and the pipeline of new opportunities across its chosen sectors will be beneficial. The UK's planned investment in economic and social infrastructure supports growth in the company's core markets. A solid financial position and disciplined focus on risk management have enabled the challenges around inflation and materials shortages to be managed effectively. These factors were said to be beginning to ease at the time of the interim results announcement. During 2022 the length of time taken to enter new contracts increased, initially in response to rising inflation and later due to delays in public sector decision making. This was also starting to normalise, providing further reassurance.

The company continues to trade well and won a number of key frameworks and contracts in the period. It also benefited from having sight of a strong future pipeline of projects and is well placed for the financial year to 30 June 2023, with profit expected to be towards the upper end of the range of analyst estimates at the time.

On 8 June the company announced that settlement had been agreed with a major infrastructure fund, allowing the payment of a special dividend. This related to a long-standing dispute concerning three contracts with entities owned by the major infrastructure fund. The settlement has ended what was described as a 'complex and challenging multi-contract dispute'. The agreement means that Galliford Try will receive a cash payment of £26m and the company expects to report a one-off non-cash write-off of approximately £3m in the current financial year. A substantial proportion of the proceeds will be returned to shareholders over time although the company will be retaining an element of the proceeds to invest in its growth strategy. A special dividend of 12p per share will be paid on 27 October to shareholders on the register as at 6 October 2023.

On balance we believe that now is a good time to invest. Full year results are set to be released on 20 September and the trading update next month will provide a very good indication as to how the company has performed in the financial year which is reaching its conclusion. There are risks and the macroeconomic outlook is a concern but this is priced in and the fact that a high proportion of forecast revenue has good visibility means that the shares are a **BUY**.



	Year Ending 30 June	Turnover (£m)	Adjusted Pre-Tax Profit (£m)	Adjusted Earnings Per Share (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
Share Price: 197.8p	2022	1,237	19.1	16.0	12.4	8.0	4.0
Market Capitalisation: £207.6m	2023 (est)	1,377	20.1	17.4	11.4	8.5	4.3
2022/23 Share Price Range: 207.1p/145p	2024 (est)	1,453	23.5	19.5	10.1	12.0	6.1
Website: <a href="http://www.gallifordtry.co.uk">www.gallifordtry.co.uk</a>							



## Aggressive Growth Portfolio VIII

It is disappointing to report that the portfolio has fallen once again over the last month, especially as the fall is quite significant at 5.0%. Although the benchmark indices have also declined, the falls have not been as significant as can be seen from the table below. The decline in the value is largely attributable to two stocks, *Inspired* and *Costain*, which have seen share price falls of 12.7% and 17.3% respectively. In fairness, these falls seem mainly due to profit-taking as opposed to anything fundamentally wrong with either stock.

In the circumstances we have therefore decided to take some profit out of the holding of *Inspired* and have sold 15,000 shares at 10.7p. This has raised net proceeds of £1,589 for a gain of £423. We have then decided to also take the gain on the holding of *Sanderson Design*, as recent increases

in interest rates may impact consumer spending. The disposal of 3,000 shares at 128p raised net proceeds of £3,802 for a gain of £651. Finally, we have unfortunately had to sell the holding of 750 *SThree* at 375p as the share price fell through the stop-loss limit. This raised net proceeds of £2,785 for a loss of £584.

There have been a number of company announcements made during the month and these have come from *Hargreaves Services*, *Synectics*, *Headlam Group*, *Vesuvius*, *Capita* and *SThree*. Those we regard as most important have been covered in the News Highlights section, but all of them are featured on the website.

Dividends were received during the month from *Headlam Group* (£129), *Vesuvius* (£126) and *SThree* (£83) and following the investment into the two main recommendations this month there is £5,914 left on deposit pending investment. Although this is a larger amount to hold in cash than usual, we are happy with this given current market uncertainties.

### Performance summary

	20 June 2023	16 May 2023	Gain/(Loss) %
Portfolio Value	£60,051	£63,225	(5.0)
FTSE 100 Share Index	7,569.31	7,751.08	(2.3)
FTSE All Share Index	4,125.41	4,224.76	(2.4)
FTSE AIM All Share Index	785.18	812.04	(3.3)

Security	Buying Price (p)	Total Cost (£)	Current Price (p)	Value (£)	Stop-Loss Limit (p)
500 Hargreaves Services*	264	1,334	408	2,040	280
12,000 Renold	25.1	3,042	29.1	3,492	20
2,825 Synectics	92.5	2,639	107.5	3,037	75
2,000 Halfords Group	148.8	3,021	191.7	3,834	120
2,800 Learning Technologies	110.2	3,116	92.35	2,586	80
1,150 Headlam Group	280	3,268	266	3,059	225
30,000 Inspired	7.7	2,333	10.7	3,210	5.5
800 Vesuvius	402.8	3,270	413.6	3,309	320
8,000 Costain	40.4	3,280	44	3,520	32
11,500 Capita	27.5	3,210	30.28	3,482	20
1,075 Braemar	307.5	3,355	281	3,021	250
1,250 Restore	291	3,673	255	3,188	235
750 Aviva	419	3,189	393.9	2,954	350
11,000 Marston's	34.8	3,885	29.55	3,251	29.5
2,750 UP Global Sourcing	132	3,684	138.75	3,816	105
1,650 Galliford Try	197.8	3,313	197.8	3,264	155
1,000 Babcock International	307.4	3,120	307.4	3,074	250
£5,914 Cash	-	-		5,914	
			TOTAL	£60,051	

Start date: 19 January 2021 with £50,000. Cash includes dividends received of £2,926 \*after part disposal.

BAB

307.4p

### BABCOCK INTERNATIONAL GP.

SECTOR - AEROSPACE AND DEFENCE  
RECOMMENDATION - BUY

Shares in *Babcock* stand at broadly half the level where they ended 2019. Having slumped in early 2020, a meaningful recovery in the company's valuation is yet to materialise but the shares now trade on a modest multiple of both historic and prospective earnings. An anticipated return to the dividend list is another key positive and it should be a matter of time before there is a rally.

The company is an international defence specialist, currently operating in the UK, Australasia, Canada, France and South Africa. It also exports to additional markets which have the potential to become 'focus countries'. It was founded in 1891 and now supports customers' defence capabilities and critical assets through a range of produce and service solutions.

On 20 April the company issued an update on trading for the year ended 31 March 2023 and the Type 31 contract. Cash flow for the financial year in the spotlight was significantly ahead of expectations, reflecting strong operational performance and the conclusion of the disposal programme,

which means dividend payments are likely to resume in the current financial year. Net debt as at 31 March 2023 was around £350m before operating leases. Group underlying profitability for the year to 31 March 2023 was in line with expectations, excluding the potential one-off impact of the Type 31 contract.

In November 2019, Babcock was awarded the Type 31 contract by the UK Ministry of Defence to deliver five Inspiration Class frigates for the Royal Navy, based on Babcock's Arrowhead 140 hull design, at an average production cost of £250m per ship. The programme is expected to conclude in 2028 and additional unexpected costs mean that a one-off provision of between £50m and £100m could be necessary. Babcock has been unable to reach agreement with the customer as to who is responsible for the additional costs under the contract. As a result, a dispute resolution process under the contract has commenced and this may lead to an arbitration.

The Type 31 contract issue is an unwelcome distraction and has no doubt held the share price back. However, it has arisen through exceptional circumstances and appears to be a one-off which is now fully priced in. Aside from this the business is making good progress and we feel that now is an opportune time to **BUY**.

	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: 307.4p	2022	4,102	202.8	28.8	10.7	-	-
Market Capitalisation: £1,554m	2023 (est)	4,091	241.8	32.4	9.5	-	-
2022/23 Share Price Range: 360.6p/268.6p	2024 (est)	3,875	286.3	37.7	8.2	11.9	3.9
Website: <a href="http://www.babcockinternational.com">www.babcockinternational.com</a>							

# News Highlights

## DX Group



31p 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.

## Alliance Pharma - 54.4p

The AIM-listed international consumer healthcare company issued a trading statement to coincide with its AGM which revealed that sales in the first four months of 2023 were ahead of the same period in 2022. However, adverse currency movements, particularly the strengthening of sterling against the US dollar and higher interest rates may mean that adjusted pre-tax profits for the year may be slightly lower than expected. Previous expectations were for adjusted pre-tax profits of £37m for 2023 for earnings per share of 5.3p - if these now come in at £35m and 5.0p respectively the shares still do not look expensive, and we re-iterate our recommendation of **BUY**.

## Hargreaves Services – 408p

The AIM-listed diversified industrial group has issued a trading update ahead of the results' announcement for the year to 31 May. The company expects to produce results at least in line with expectations with a strong performance from the Services business, which has benefited from the HS2 contract, and a better than expected performance from HRMS, the German joint-venture commodity trading business. These will offset the impact of some delayed transactions in Hargreaves Land. We continue to believe that shares in the company look cheap especially as the company had cash reserves of £22m as at 31 May. Full year results will be out on 26 July, but we continue to rate the shares as a **BUY**.

## SThree – 363.5p

The recruitment group has issued a trading update covering the six-month period to 31 May and this has confirmed that trading has remained resilient during the period. Net fees were down 2% compared with the previous year although the latter period was

particularly strong, benefitting from high levels of business post Covid. In the group's largest three markets, which represent 73% of net fees, the Netherlands grew 3%, Germany was down 1% and the USA was down 11%. The group retains a strong balance sheet and had net cash balances of £72m as at 31 May, up from £48m a year earlier. The group has a particular focus on Science, Technology, Engineering and Mathematics, which it sees as areas of significant growth going forward. The share price has fallen back and now stands at its lowest point since last October but with earnings per share of some 38p forecast for the full year the shares stand on a very modest rating and look due a rebound. The shares are a **BUY**.

## Capita – 30.28p

The outsourcing group has announced that it has won a new contract with the City of London Police to provide services to the force's new fraud reporting service. The contract, which will run from 2024 for a period of 5 years, is worth £50m during its life. The group has also sold its non-core software businesses in another disposal of non-core assets. Capita expects to receive cash proceeds of £44m on completion and this is another step in exiting all of its non-core businesses in the first half of the year. The recent weakness in the share price, which has dropped from 42.5p in March has presented an excellent buying opportunity in our view. **BUY**.

## Headlam Group – 266p

The UK's leading floor coverings distributor has issued a trading update to coincide with its AGM and this has revealed that revenues in the first four months of the year were 3.4% ahead of the same period last year. Weak residential sales were offset by stronger revenues from larger and trade customers and the commercial sector also performed well. However, one result of this change in mix has been that profit margins have fallen, and the group is taking mitigating action to counter this including cutting costs, launching new products and raising prices. The overall profit for the year remains dependent on consumer sentiment in the residential market although

the fear of higher living costs is likely to prove detrimental in this regard. The shares have fallen back from 315p in March when the 2022 results were announced, a decline of over 15%, and we believe that this is too pessimistic a view. The shares are a **BUY**.

## DX Group – 31p

The delivery and courier group has announced that it has reached a full and final settlement with Tuffnells Parcels Express in relation to the claim against the company as announced in February. No financial details were given, but this will not have any impact on the group's results for the current financial year. The group has also announced details of a major expansion in the East Midlands with plans to build a major new regional hub near Nottingham at the New Stanton Park Industrial Estate. The new hub is expected to cost £12m and will include a new depot serving the local area. The hub will have a 25,000 sq. ft footprint and will be developed to service the group's parcel freight activities. The hub and depot will provide significant additional regional capacity and should improve efficiency. Shares in the company have moved up of late to the highest level since 2021 but there should be further to go. **BUY**.



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