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Your monthly guide to a range of ideas from the WH Ireland team

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LONG TERM UK RESIDENTIAL PROPERTY EXPOSURE

Grainger (GRI)

FTSE Mid 250 | Share price: 235p | Market Cap: £982m

www.graingerplc.co.uk

Proposed changes to the taxation treatment of mortgage interest on Buy-to-Let properties unveiled in the summer budget once again highlights the attractions of **Grainger**, the UK's largest quoted residential landlord. We brought Grainger to readers attention in the May 2013 issue of *WHI Spy* with the shares at 137p and the case for continued investment remains compelling.

Phased in from 2017 onwards, tax relief on the interest on Buy-to-Let properties held directly by individuals will be limited to the basic rate only thus giving rise to a greater income tax bill for those in the higher and additional bands. The changes do not affect properties held in corporate structures like Grainger, however, which will continue to attract full interest relief at their marginal rate of corporation tax.

What we like

To us, one of Grainger's attractions is its long term embedded value. Triple net asset value, an industry standard measure of the company's value, was last stated at 240p per share as at the end of March. On top of that, however, is Grainger's reversionary surplus, the value it expects to extract over and above its stated net asset figure as its properties are vacated by long term tenants, which is said by the company to be 120p a share. For the long term investor, ie one who waits for that benefit to accrue, there is a clear valuation opportunity here.

Little wonder, then, that the company has attracted the attention of activist shareholder Crystal Amber which has built a 3% stake in Grainger and reportedly wants to look at unlocking the value of the reversionary surplus. It is argued that a long term investor such as an insurance company may be attracted to such long term assets.

Assuming a continuation of long term trends in UK residential property prices, Grainger offers traditional Buy-to-Let investors a hands-off alternative to direct bricks and mortar investment and, given the discount to underlying asset value, continues to offer attractive value at this level.

Estimates to Sep	2014 (A)	2015 (E)	2016 (E)
Revenue (£m)	57.4	58.8	59.2
PBT (£m)	47.1	40.9	43.1
EPS (p)	25.5	7.7	7.6
Gross NAV/share (p)	291	303	311
Dividend (p)	2.5	2.7	2.9

Source: Company, Consensus forecasts (Bloomberg). Analyst: Eric Burns

UK ECONOMY SPRINGS TO LIFE

According to data released by the Office for National Statistics (ONS) the UK economy showed growth of 0.7% in the second quarter of 2015. This compares with 0.4% in the first quarter of the year (the weakest pace of growth since 2013) and means the economy has now registered 10 consecutive quarters of sustained growth.

The pleasing data has been fuelled by a hike in the services sector which has been driven by increased North Sea oil & gas production following tax cuts in March. Manufacturing has proved tough due to the strength of the pound denting sales into the Eurozone. With output in the economy during the second quarter up 2.6% on last year there has been talk of an interest rate rise – it has stuck at 0.5% for six years.

Against this backdrop the often lacklustre Summer period has sprung to life at a corporate level with cash rich firms unveiling a raft of deals. Swiss giant Zurich Insurance Group is considering a potential £5bn plus cash offer for **RSA Insurance**, **Melrose** has sold its portfolio company **Elster** for £3.3bn, **Hikma Pharmaceuticals** is buying US rival Roxane Laboratories and **GKN** is to acquire Dutch engineering business Fokker for £500m.

Miles Nolan
Editor

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TRADING IDEA

Phoenix (PHNX)

FTSE 250 – Share price: 850p | Market Cap: £1.9bn | www.thephoenixgroup.com

Beazley (BEZ)

FTSE 250 – Share price: 333p | Market Cap: £1.7bn | www.beazley.com

Phoenix Group, the life and pension fund consolidator, has enjoyed a good run of performance over recent years. However, we have doubts over the quality of the earnings which are, for a large part, based on actuarial assumptions which make their models appear more favourable. We do not believe that this is sustainable. The poor quality of earnings is highlighted by significant variability in cash flow over time and we recommend investors take profits.

For reinvestment, **Beazley**, the specialist non-life insurer, offers a lower risk alternative. The group has global operations and offers diversified exposure across different markets including property, marine, reinsurance and speciality lines. Beazley has niche positions

in some of the more unusual insurance businesses. It has a recently established Space division which offers satellite insurance. Its Political Risks team insures against events including terrorism, kidnap & ransom. Recent interim results were impressive, with profitability improving, boosted by strong growth in the US. The Combined Operating Ratio fell from 90% to 86% indicating stronger underwriting performance. The interim dividend was increased by 6.5% to 3.3p. With an impressive track record, we believe it offers a valid alternative to Phoenix with a more dependable income stream.

Beazley

Actuals to Dec	2014 (A)	2015 (E)	2016(E)
Revenue(£m)	1,135	1,134	1,165
PBT (£m)	168.0	152.1	146.5
EPS (p)	27.7	26.0	25.3
P/E (x)	12.4	13.2	13.5
DPS (p)	21.1*	13.3	12.7
Yield (%)	2.6	3.9	3.7

*** including Special Dividend**
Source: Company, Starmine

Analyst: John Goodall

IMPROVING OUTLOOK BUOYS PROGRESS

600 Group (SIXH)

FTSE AIM – Share price: 18p | Market Cap: £17m | www.600group.com

The **600 Group** is a diversified engineering group with a world class reputation in the manufacture and distribution of machine tools (notably lathes), precision engineered components and laser marking systems. The Group's main manufacturing operations are in the UK. It also has sales, distribution and assembly operations in North America and Australia and sells into more than 180 countries worldwide through active distributors in over 50 countries.

What we like

The outlook for machine tools is improving in the major markets of the UK and US. In February 2015, the group expanded its operations with the acquisition of TYKMA a US based laser marking business that complemented its UK based Electrox laser marking business. TYKMA is performing well ahead of initial expectations and has now been merged with Electrox. The combined synergies and reduced costs arising from the integration are expected to drive strong profit growth in FY16. The group is also expanding international distribution to leverage its brand names and looking to further increase scale with complementary earnings enhancing bolt on acquisitions. The shares trade on a low PE rating of 7.0x FY16 earnings which compares to the sector trading at around 13.5x.

Estimates to Mar	2015 (A)	2016 (E)	2017 (E)
Revenue (£m)	43.8	52.7	56.3
PBT (£m)	2.0	2.9	3.9
EPS (p)	2.1	2.7	3.6
P/E (x)	9.1	7.0	5.3
DPS (p)	nil	nil	nil
Yield (%)	n/a	n/a	n/a

Source: Company, WH Ireland estimates

Analyst: Ian Berry

Shares purchased on the Alternative Investment Market (AIM) carry a high degree of risk of losing money. Please refer to the disclaimer on the back page for more information.

UPDATE: ADEPT TELECOM (ADT)

More to come

Share price: 242p | Market cap: £54m

AdEPT Telecom is an independent provider of telecom services focused on small and medium-sized business customers in the UK. AdEPT's shares have gained an impressive 103% since we discussed it in August 2014 at 119p, and has been the top performing stock in the telecom sector across both the AIM and Main Market. AdEPT's 2015 results, announced last month, were in line with market expectations with headline EPS growing 12% YoY. AdEPT's highly cash generative business model saw its net debt cut in half to £1.5m, whilst simultaneously increasing its dividends by a robust 58% YoY to 4.75p/ share. Interim results, which are scheduled for release in mid-November, will provide investors with a first glimpse of how the enlarged business is performing since it acquired Centrix for £7m at the start of the period. Although AdEPT's shares have rallied solidly over the past year, the company still trades at a 21% discount to its peer group of London listed small cap telecom companies, which we believe should narrow over the next 12-months.

Analyst: Brendan D'Souza

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WRAPPING UP A PROFITABLE FUTURE

International Greetings (IGR)

FTSE AIM – Share price: 155p | Market Cap: £91m | www.internationalgreetings.co.uk

International Greetings designs, manufactures and distributes a wide range of greetings and stationery products. It is currently the world's fourth largest supplier of greetings products (behind Hallmark, American Greetings and CSS). It manufactures approximately 2bn feet of gift wrap annually from three manufacturing centres located in the UK, USA and Holland each of which has its own specialist design facilities. Most of the remainder of the group's in-house manufacturing is carried out at its factory in Huizhou, China where it makes around 70m crackers a year. It also manufactures around 90m bows annually in the UK and sells tags, bags and cards, some procured but many produced at its factory in China. It has agreements with owners of many leading character licenses including Disney and Peppa Pig.

What we like

The business has undergone radical restructuring and is currently in the middle of an ambitious capital investment programme which has cut the cost base and improved efficiency. This process remains ongoing and is contributing to the current strong growth in profit. The group has upgraded its manufacturing facilities in China with the relocation to a modern facility providing additional capacity, greater efficiency and a higher degree of automation. In Holland, high speed printing presses were installed. Most recently a similar upgrade of facilities was completed in Wales which has led to major productivity benefits. Further improvements in operating margin are being targeted which should help facilitate continued profit growth. Encouragingly, the execution of the investment programme has been achieved whilst also reducing gearing.

Revenue is currently running at record levels helped by expansion of its customer base which includes many of the leading global retailers such as Costco, Walmart, Tesco and Amazon. The combination of in-house design and worldwide sourcing enables the Group to act as a one-stop-shop for retailers for a comprehensive range of greetings products. The shares trade on an undemanding forward PE of 12.8x for 2016, which is an undeservedly low rating for a business that is growing strongly, increasing its reach worldwide and has the potential for earnings accretive acquisitions.

Estimates to Mar	2015 (E)	2016(E)	2017(E)
Revenues (£m)	229	234	237
PBT (£m)	9.2	10.0	11.0
EPS (p)	10.7	12.1	12.6
P/E (x)	14.5	12.8	12.3
DPS (p)	1.0	2.0	3.0
Yield (%)	0.6	1.3	1.9

Source: Company, Morningstar

Analyst: Miles Nolan

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UPDATE: FLOWTECH FLUIDPOWER (FLO)

Consolidation continues apace

Share price: 142p | Market cap: £61m

Fluid power products distributor **Flowtech Fluidpower** has cemented its position as the UK market leader with the £7m acquisition of two businesses: Nelson Fluid Power and Albroco. Both companies sell hydraulic products and bring the enlarged group a wider customer base and scope to deliver useful synergies by a strengthened sales approach as well as operational/procurement benefits. Last year Flowtech established a newly formed division focused on Power and Motion Control (PMC) – including the latest acquisitions the combined entity now enjoys sales of c£17m.

Flowtech has acted as the industry consolidator at a time when market conditions remain difficult. Adjusted EBITDA of £7.8m and adjusted EPS of 12.9p are expected in the year to December 2015, rising to £9m and 15p respectively the following year (Source: Capital IQ).

We discussed the company at 127p in July 2014 – after the 16% rally, the shares remain undervalued.

Analyst: Miles Nolan

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FUND MANAGER SPOTLIGHT

Leigh Himsworth | Fidelity | www.fidelity.co.uk

Experienced fund manager Leigh Himsworth runs the **Fidelity UK Opportunities Fund** which aims to deliver consistent long term returns. He moved his fund to Fidelity from City Financial last year but his career spans nearly 20 years with stints at Gartmore, Royal London Asset Management, Rensburg and the Nestle Pension Fund.

Himsworth says, "The aim is to identify growth opportunities before other investors get to them". In the year to June 2015 the fund is up 8.8% but over a 5 year period Himsworth has delivered a 115% return.

The £65m fund is benchmarked against the FTSE All Share Index and currently holds 49 stocks – this is split 27% FTSE 100, 47% FTSE 250, 23% in Small Cap/AIM and the balance in cash.

The focus tends to be on investing thematically and to identify stocks which he believes are due a re-rating. Another point he highlights is that though he remains sanguine on the prospects for the UK economy, a large proportion of the stocks he holds generate revenue overseas.

He argues the current low interest rate environment and pension deregulation as reasons to back pension administration group **Mattioli Woods** and wealth management specialist **St James's Place**. In order to benefit from the drive to media content ownership he has picked **British Telecom** and **ITV**, whereas the stocks he holds in order to capitalise on increasing consumer spend are pubs chain **Enterprise Inns** and fashion brand **SuperGroup**.

Another area Himsworth hopes to profit from is the evolution of the internet and ecommerce – to this end he has taken significant positions in data verification firm **GB Group** and online payment services providers **SafeCharge** and **Optimal Payments**. Special situations he favours include engineer **Renold** and niche components manufacturer **e2v technologies** which recently appointed a new CEO. He tends to be more of a stock picker but avoids biotech and mining situations due to their higher perceived risk. In addition to his own market knowledge he also benefits from the 40 strong bank of equity analysts at Fidelity.

Drilling down into company accounts he looks to identify the true net debt/cash position of the company to ascertain an accurate Enterprise Value – this is to determine what a predator might have to pay for a stock and if there is any likely upside. He regularly trades out of shares when he sees them as fully valued, indeed he takes the view that he can always buy back in at a later date when the valuation is more attractive.

Though the IPO market has witnessed a number of new entrants Himsworth remains sceptical of the motives. "Why are the most knowledgable investors – the directors and/or private equity selling?", he says.

Analyst: Miles Nolan

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