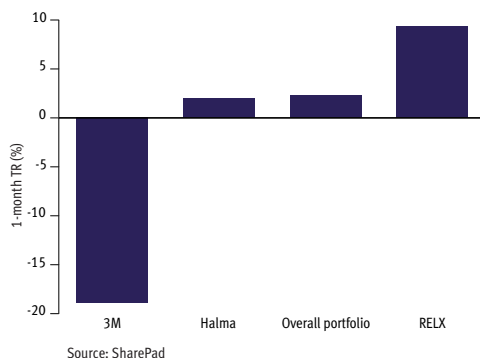




Phil Oakley's Weekly Round-Up

Despite the strong performance of my Fantasy Sipp over the past month, I don't feel very bullish. Quality shares are expensive amid growing signs of economic weakness

Best, worst and middle Fantasy Sipp 1-month performers



The companies mentioned this week are:

- BT
- Greggs
- Portmeirion
- Barratt Developments
- SSP

Fantasy Sipp performance

	1 month	Portfolio returns (%) YTD	1 year
Finsbury Growth & Income Trust	4.5	18.7	13.9
Phil Oakley Fantasy Sipp	2.3	17.3	17.0
Lindsell Train Global Funds plc	1.8	15.6	19.7
Fundsmith Equity T Acc	-1.1	15.1	15.3
Castlefield CFP SDL UK Buffettology Fund	3.5	14.5	12.4
Vanguard S&P 500 ETF	0.2	13.1	10.3
Scottish Mortgage Investment Trust	-0.4	11.6	4.4
FTSE All-Share - Total Return	-1.5	10.6	-2.0

Source: SharePad

The Fantasy Sipp continues to chug away quite well and is beating its benchmarks of the FTSE All-Share index and the S&P 500.

The portfolio has performed very well relative to the UK and US markets in the past month, with 16 out of 21 shares in positive territory. The best performer was RELX and the worst performer was 3M, which had a disappointing set of results.

Alpha Production Editor: Sameera Hai Baig

Name	1 month TR %
RELX	9.35
London Stock Exchange Group	8.31
Spirax-Sarco Engineering	7.32
Diageo	6.3
James Halstead	6.11
Mastercard	4.88
Pepsico	4.69
McDonalds	4.03
Paychex	3.94
InterContinental Hotels Group	2.98
Avon Rubber	2.39
Halma	1.95
Visa	1.54
Walt Disney Co (The)	1.52
Croda International	1.15
Sage Group (The)	1.13
Vanguard S&P 500 ETF	0.155
Moody's	-0.98
FTSE All-Share – total return	-1.51
Intertek Group	-1.58
WH Smith	-4.51
British American Tobacco	-7
3M	-18.9

Source: SharePad

Despite the strong performance of the portfolio and stock markets in general, I don't feel very bullish. Valuations of high-quality shares remain very high, yet there are signs of growing economic weakness everywhere.

The bond market is always a reasonable gauge of the economic outlook even in these days of central bank interventions. German bond yields are falling, with yields of negative 0.11 per cent on the 10-year bund, at the time of writing.

I think bond yields could continue to go much lower – especially in the US where the 10-year treasury yield is 2.37 per cent – but I wouldn't view this as being good news for stocks, as it would mean weaker growth and maybe lower corporate profits.

The yo-yo of sentiment on the US-China trade dispute continues to weigh on sentiment and actual growth. The Chinese economy looks like an accident waiting to happen to me with bank assets now around four times the size of the economy. This compares with two times in the US at the time of the financial crisis. Chinese retail sales were the weakest since 2003 this week.

Despite these views, I can't predict the future and nor can anyone else. I am also not going to try and time the market. The portfolio is intended to be for all weathers and will experience ups and downs – perhaps big ones – and if you can't cope with this and the fear of the value of your portfolio going down then there's always the bond market instead.



BT

At the end of last year I got it into my head that **BT (BT.A)** could be an interesting share for contrarian value investors. An incoming CEO could shake the business up by breaking the company up, selling Global Services and perhaps spin off its Openreach infrastructure division.

Last week's full-year results make me think that this was foolish thinking.

BT looks to be in a bit of a mess. The only bright spot is the success of its Consumer division where home broadband and the EE mobile business. Elsewhere, there is no growth and lots of future investment expenses. This is going to eat into BT's free cash flow and lead to a bigger debt pile. With large amounts of ongoing cash needed to plug the company's large pension fund deficit, I think a dividend cut – and potentially quite a big one – this year is almost inevitable.

BT's free cash flow performance last year was horrible due to higher pension fund top ups and higher capex. It is nowhere near enough to meet the £1.5bn cost of the annual dividend. With capex going up to invest in fibre to the premises (FTTP) broadband it's not going to come close this year either, despite what the forecasts below say (these seem to ignore pension top-up payments).

BT Free cash flow (£m)	2019	2018
Operating cash flow	4687	5400
Interest received	23	7
Cash coming in	4710	5407
Tax paid	-431	-473
Capex	-3678	-3362
Interest paid	-531	-555
Cash going out	-4640	-4390
Free cash flow	70	1017
Cash dividends paid	1504	1523
Free cash dividend cover	0.05	0.67
Cash shortfall	1434	506

Source: BT

The only part of BT where I'm relatively bullish is its consumer division. Its commitment to offering better value for money and limiting price increases to inflation is a good one, in my view. It is the only operator offering a fully converged broadband, fixed-line and mobile product which, in my experience, is very good. Its mobile customer churn rate of 1.1 per cent is evidence of its attraction to customers. Its quick start in offering 5G services also bodes well.

For me, I am not sure it makes sense for BT to continue owning Openreach anymore. It may well be forced to open up its network to other full fibre infrastructure providers, while its returns are capped by the regulator. Spinning it off would please the regulator and may be a good move if



BT can get rid of most of its pension deficit and debt with it.

Selling Openreach would result in a dividend cut but that's what most people expect now anyway. A cleaner, leaner business based on EE mobile networks and consumer and business broadband may not turn BT into a growth stock, but it would be a lot more appealing than its current business mix.

BT forecasts

	2020	Year (£m) 2021	2022
Turnover	23,016.00	23,041.80	23,035.80
Ebitda	7,270.00	7,401.30	7,454.10
Ebit	3,558.10	3,822.70	3,869.70
Pre-tax profit	2,840.90	3,123.20	3,303.80
Post-tax profit	2,344.50	2,488.30	2,459.50
EPS (p)	25.3	26.2	26.8
Dividend (p)	15.4	14.5	14.5
Capex	3,812.10	3,794.70	3,790.80
Free cash flow	2,010.70	2,418.10	2,383.30
Net borrowing	12,166.60	13,006.40	12,410.60

Source: SharePad

Greggs

I am a big fan of **Greggs (GRG)** as a business for many reasons. I like the fact that it makes a lot of the food that it sells, but above all, I think it offers fantastic value for money to its customers. You walk into a Greggs shop and walk out with a decent lunch for far less than more up-market places such as Pret a Manger.

Greggs is experiencing a purple patch in trading at the moment mainly down to the success of its vegan sausage roll, but also the continued strength of its breakfast and coffee sales. It is not resting on its laurels either, with a new vegan wrap coming to shops soon, as well as offering a post 4pm offer of a slice of pizza and a drink for just £2.

Like-for-like (LFL) sales for the 19 weeks to 11 May increased by a stunning 11.1 per cent, which implies that sales growth accelerated to 12 per cent in the 10 weeks since the last trading statement. Cost inflation remains in line with expectations and consequently profits for the year could be materially higher than previous expectations.

What does this mean in terms of earnings per share (EPS)? A rough guess would assume that 'materially higher' means more than 10 per cent, so an EPS forecast of 90p would not be too far off the mark. If this is broadly right then the shares, at 2,100p, trade on a forecast PE of 23.3 times.

Companies that communicate value to their customers are always going to do well, especially in a world where people's wages barely keep up with the cost of living. This bodes well for Greggs and its future prospects.

The company is also helping itself by closing shops on declining high streets and moving them to railway stations, airports, motorway service stations and university campuses and often doing this with franchises. This is significantly improving the quality of the shop estate and still has some way to run.

Greggs shares look fairly expensive now and growth next year will come up against some tough comparatives. That said, it is a really nice business and current shareholders should enjoy the ride.

Greggs forecasts

	2019	Year (£m) 2020	2021
Turnover	1,142.10	1,204.70	1,287.40
Ebitda	180.7	189.5	194.2
Ebit	109.2	115.4	124.8
Pre-tax profit	107.2	114	121.3
Post-tax profit	86.1	92.6	99.6
EPS (p)	80.6	89.6	95.8
Dividend (p)	40.3	44.6	48.1
Capex	91	88.1	79.4
Free cash flow	41.7	72.7	85.5
Net borrowing	-81.8	-59.4	-89.2

Source: SharePad



Portmeirion

Portmeirion Group (PMP) is based in Stoke-on-Trent and is a leading maker of homeware products such as tableware, cookware, placemats, candles and fragrances. It trades under some well-known brands such as Portmeirion, Botanic Garden, Royal Worcester, Pimpernel, Spode and Wax Lyrical.

Around half its products are manufactured at its own site in Stoke-on-Trent, with the other half bought in from third party suppliers. The UK, USA and South Korea are its main markets accounting for just over 74 per cent of its total sales. The business is also highly seasonal with the bulk of its profits being made in the second half of its financial year, as its products are often bought as Christmas gifts.

The company's manufacturing footprint in the UK means that this business has a lot of fixed costs that need to be covered before it makes a profit. These fixed costs give it a high amount of operational gearing and make its profits very sensitive to changes in sales – the percentage change in profits is greater than the percentage change in sales.

This is a good thing when sales are rising, but not so good when they are falling. In short, the manufacturing plants need to be kept busy to keep profits moving up.

Sadly for Portmeirion shareholders, this week's trading

update covering the first four months of its financial year reported that its total sales for the year to date were down by 10 per cent and that profits for the year would be below market expectations as that operational gearing kicks in.

UK sales were up by 5 per cent and US sales were up by 8 per cent, which is encouraging. It seems that sales in South Korea (9 per cent of total sales in 2019) have fallen off a cliff after increasing by nearly 25 per cent in 2018.

This has led to accusations of channel stuffing – where a company sells more goods to its distributors in a year to boost its sales – by some more astute private investors that I follow on Twitter. Hindsight is a wonderful thing, but a red flag could have been seen by examining Portmeirion's 2018 accounts and credit to one of my Twitter followers that he commented on it at the time.

Portmeirion (£m)	2018	2017
Sales	89.594	84.769
Trade & other recs	15.638	12.431
%	17.45%	14.67%

Source: Annual report

One very revealing calculation you can easily do from a company's accounts is to compare trade and other receivables with the level of annual sales. This tells you how much of the company's sales have invoices outstanding at the balance sheet date. A big rise in the ratio – as seen with Portmeirion in 2018 – can be a sign that a company is aggressively offering customer credit to flatter its sales and profits.

If this is what has been going on with Portmeirion then the effect going forward has a number of implications. It is likely to mean that its South Korean distributors will run down their excess stocks and order less products. This may also have implication for the loading of the UK manufacturing plants and lead to slightly lower overhead absorption from goods made for the Korean market but this effect will not be massive given the size of South Korean sales relative the rest of the business.

Portmeirion forecasts

	2019	Year (£m) 2020	2021
Turnover	89.9	93.2	96.5
Ebitda	11	12.2	13.1
Ebit	9.3	10.2	10.8
Pre-tax profit	8.9	9.8	10.5
Post-tax profit	7.7	8.2	8.6
EPS (p)	71.9	76.1	80
Dividend (p)	38.2	40.2	42.1
Capex	1.9	1.8	1.8
Free cash flow	4.8	5.5	5.9
Net borrowing	-2.5	-4	-6.5

Source: SharePad



I think Portmeirion is a fairly decent business but the operational gearing, seasonality and cyclical nature of its business would put me off it as a long-term investment. This week's trading statement was very short on detail and the concerns on possible channel stuffing will not have endeared it to investors.

Barratt Developments

The current theme in the UK new build housing market is one of lower house price inflation, rising costs and pressure on profit margins. Given this backdrop, **Barratt Developments (BDEV)** is doing quite well, but is having to work harder to stop margins from falling.

Last week's trading update for the four months to May was reassuring with the company saying that profits for the year to June are expected to be modestly ahead of its previous expectations.

Revenues and volumes

	5 May 2019		6 May 2018			
	£m	Units	£m	units	% change £	%change units
Private	1821.9	5924	2198.4	6530	-17.1%	-9.3%
Affordable	1186.7	7496	816.6	6296	45.3%	19.1%
Wholly owned	3008.6	13420	3015	12826	-0.2%	4.6%
JV	356.5	761	271.7	829	31.2%	-8.2%
Total	3365.1	14181	3286.7	13655	2.4%	3.9%

Source: Barratt Developments

What's interesting is that the company is achieving this with a change in sales mix. Modest revenue growth overall is being driven by a big increase in sales of affordable housing and a decline in private housing. Is this a sign of things to come as the higher end of the market suffers from affordability problems, despite the government's Help to Buy scheme?

Average selling prices

Average Price (£000)	May 2019	May 2018	% change
Private	307.55	336.66	-8.6%
Affordable	158.31	129.70	22.1%
Wholly owned	224.19	235.07	-4.6%
JV	468.46	327.74	42.9%
Total	237.30	240.70	-1.4%

Source: BDEV/Investors Chronicle

The company is still confident of buying 18,000-22,000 new plots for the next three years, which will allow it to achieve gross profit margins of at least 23 per cent and return on capital employed (ROCE) of at least 25 per cent, which is pretty decent in anyone's book.

The key risk may be volumes which are expected to be at the lower end of the company's 3-5 per cent target. Margin pressure is being dealt with through efficiency projects

and redesigning cost out of its houses. The company is confident that it can do this without compromising on build quality.

Barratt Developments forecasts

	2019	Year (£m) 2020	2021
Turnover	4,910.20	4,963.10	5,136.40
Ebitda	901	908.4	957
Ebit	897.1	907.9	951.9
Pre-tax profit	871.8	864.4	894.8
Post-tax profit	711.5	711.1	740.7
EPS (p)	69.4	68.9	71.8
Dividend (p)	45.4	46.2	48.3
Capex	7.7	8.1	9.1
Free cash flow	441	574.4	614.2
Net borrowing	-786.1	-895.5	-1,039.30
NAV	4,005.50	4,329.00	4,690.00

Source: SharePad

I'm bearish on housebuilders in general. The windfall gains they have earned from the government's Help to Buy scheme may be coming to an end. New build price premiums over existing housing stock is around 15 per cent, which represents very poor value for money for buyers in my opinion. Barratt's shift to more affordable housing may be a reflection of this.

At 612p, the shares trade on a rolling forecast one-year PE of nine times and offer a yield of 7.4 per cent underpinned by further returns of capital.

I don't see the shares crashing and see them supported by the dividend stream in the short term. I do think it will become more difficult for the company and its peers to keep average selling prices high without offering more incentives such as stamp duty payments and maybe more generous part exchange deals, which could eat into margins.

The redesigning of its homes to reduce costs is not without risks, as build quality – as with Persimmon, Taylor Wimpey and Bovis – is becoming more noticeable and newsworthy when the sector is receiving billions of pounds in taxpayer subsidised mortgages to buy their homes.



SSP Group

I like **SSP Group (SSPG)**, as there is growth potential in its airport business (nearly two-thirds of sales) in the US, Asia and South America. Half-year results were good, with operating profits up by 13.2 per cent. Operating margins continued to nudge up by 30 basis points.

Gross profit margins continue to rise, while good progress has been made on overhead costs (with things such as self-service tills in its shops). This is needed as labour costs continue to rise, as do concessions fees, as the business continues to take on more airport concessions where fees tend to be higher.

Not everything in the garden is rosy, though. The UK rail business remains weak and the European business saw profits fall. The slowdown in LFL sales from 2.5 per cent in the first quarter to 1.5 per cent in the second quarter is a little bit worrying, and perhaps makes full-year forecasts of 2.6 per cent growth look a little bit difficult to achieve.

The good news is that the company is winning new contracts – 48 in the first half – and now has 80 units in the pipeline. This is driving a big increase in capex, but with new units capable of earning good returns on investment, this is a good thing.

The big working capital outflow of £36m in the first half did catch my attention and did concern me, but the company has explained that this is due to the timing of Easter and that the business is still expected to have negative working capital for the full year.

At 698p, the shares trade on a one-year forecast rolling PE of 23 times. The growth from new outlets suggests that this company has decent long-term growth potential, but the trend in LFL sales worries me a little. I continue to think that the shares are up with events.

SSP forecasts

	2019	Year (£m) 2020	2021
Turnover	2,745.00	2,891.90	3,039.10
Ebitda	321.4	344.6	367.3
Ebit	214.5	230.8	248.9
Pre-tax profit	201.1	217.3	239.5
Post-tax profit	133.2	142.7	155.5
EPS (p)	28.4	31.3	34.3
Dividend (p)	11.6	12.7	14
Capex	149.6	153.2	157.8
Free cash flow	129.5	174.2	168
Net borrowing	443.1	383.2	310.1
NAV	399.3	519.5	-
Like-for-like sales growth (%)	2.6	2.8	2.5

Source: SharePad

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