



## Phil Oakley's Weekly Round-Up

*I am making the right choice to sit tight, although a couple of my Fantasy Sipp holdings look ripe for profit taking. This week I examine six companies in depth*

The companies mentioned this week are:

- Card Factory
- JD Sports Fashion
- Galliford Try
- Stagecoach
- National Express
- WH Smith

### Fantasy Sipp

Funds % returns	1 month	Year-to-date	1 year
Fundsmith Equity T Acc	4.5	16.6	24.1
<b>Phil Oakley Fantasy Sipp</b>	<b>6.3</b>	<b>15.4</b>	<b>22.2</b>
Finsbury Growth & Income Trust	5.49	14.9	16.3
Lindsell Train Global Funds	5.14	14.1	26.4
Scottish Mortgage Investment Trust	6.97	13.7	17.4
Vanguard S&P 500 ETF	4.29	13.5	17.6
FTSE All-Share – Total Return	3.47	12.8	6.94
Castlefield CFP SDL UK Buffettology Fund	6.11	11.3	12.1

Source: SharePad

The Fantasy Sipp continues to do quite well and is beating the FTSE All-Share index and a Vanguard S&P 500 tracker fund so far this year – but not by much. The portfolio has received a boost from the rise in the share price of Walt Disney (**NYSE:DIS**) after it released news of its new streaming service to be released in the autumn.

As you can see from the table above, many stocks in the portfolio have risen sharply since the start of the year. You will also notice that many shares are now trading on very full valuations based on their forecast one year rolling earnings per share (EPS).

Alpha Production Editor: Sameera Hai Baig

### Performance year-to-date by stock

Name	Total return, year-to-date	PE roll 1
Moody's Corp	35.1	23.5
Spirax-Sarco Engineering	28.8	30.2
Mastercard	27.5	30.2
Halma	27.5	31.4
Paychex	26.5	26.6
British American Tobacco	26	9.7
WH Smith	23.4	17
Visa	21.9	27.7
London Stock Exchange Group	21.7	24.8
Walt Disney Co (The)	20.1	19.3
Sage Group (The)	19.5	22.3
InterContinental Hotels Group	16.1	19.9
3M	15.2	20.2
Pepsico	15.2	21.7
FTSE All-Share – total return	12.8	
James Halstead	12.6	24.8
Diageo	12.3	23
Avon Rubber	12.2	18.1
Intertek Group	9.88	24.7
McDonalds	8.55	23.1
Croda International	8.28	24.5
RELX	4.7	18.3

Source: SharePad

Halma and Spirax -Sarco have undergone a significant upwards re-rating and now arguably look very expensive despite being outstanding businesses in my view.

The valuations are so high that you might feel that it could be an idea to take some profits. A pullback would not surprise me as the gains all seem too easy at the moment, which always makes me feel a little bit nervous. I am going to stay disciplined and do nothing and like everyone else see what happens.

### Card Factory (LSE:CARD)

Investing in a business that makes and sells greetings cards along with gifts doesn't really grab me, but Card

### Card Factory (LSE:CARD)



Source: SharePad

Factory looks like it does a good job. The company is vertically integrated which means it designs and prints its own cards rather than buying them in from third-party suppliers. Cutting out the middleman saves money and allows Card Factory to sell cards to its customers at very cheap prices. It does this through a network of 965 rented shops and over the internet.

This company's shares had been popular with investors due to its big dividend payouts. However, these have come to an end due to increases in debt and profits' growth stagnating as wage costs have outstripped sales growth.

This trend continued in the year to January 2019 with sales increasing by 3.3 per cent to £436m – like-for-like sales were flat – but operating profits fell by 5.9 per cent to £70.8m. Operating margins still remain very healthy due to the benefits of operational gearing and were 16.2 per cent. Not many retailers are achieving that level of profitability.

Card Factory continues to argue that the market for cards is holding up well. The UK market is growing slightly in terms of value but is falling slightly in volume terms. Eighteen to 34-year olds are a key part of the market and continue to buy more cards. Interestingly, there has been no significant shift towards digital cards.

Despite its name, Card Factory makes almost half its sales (44.6 per cent) from selling gifts and accessories at cheap prices which seem to be holding up reasonably well.

The company is still optimistic that it can extend its store footprint from 965 currently, to 1200. By doing this it is flying in the face of current retailing trends where increased exposure to the high street is seen as a problem rather than something to be embraced.

That said, I'm not sure that this is a great strategy as it just exposes the business to lots of extra fixed costs such as wages and rents. At the moment increasing the number of stores is not doing anything for the company's profit growth, and based on current analysts' forecasts, are not expected to do so.

Card Factory's market share is holding up well at 32.4 per cent by volume and 19.3 per cent by value. I think there's a lot to like about its vertically integrated business model and how this creates a strong value for money offer to customers.

The problem facing the company is a lack of growth. Many retail businesses would love to have a lease adjusted return on capital employed of 14.5 per cent and free cash flow margins of 16.1 per cent, but as far as shareholders are concerned growth matters.

The shares are not expensive due to the lack of growth. At 187p they trade on a trailing price/earnings (PE) ratio of

## Card Factory forecasts

Card Factory PLC (CARD)

### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	435.6	+3.2%	452.5	+3.9%	470.0	+3.9%
EBITDA	88.6	-5.8%	88.8	+0.2%	90.0	+1.4%
EBIT	77.4	+2.6%	77.1	-0.4%	77.9	+1.0%
Pre-tax profit	74.2	+2.0%	73.9	-0.4%	74.6	+0.9%
Post-tax profit	59.5	-8.0%	59.4	-0.2%	60.6	+2.0%
EPS (p)	17.3	-8.5%	17.3	0.0%	17.6	+1.7%
Dividend (p)	13.8	+48.4%	13.8	0.0%	14.8	+7.2%
CAPEX	13.3	+1.5%	13.5	+1.3%	13.6	+1.2%
Free cash flow	58.7	+2.9%	56.2	-4.2%	57.6	+2.5%
Net borrowing	155.8	-3.2%	153.9	-1.2%	148.8	-3.4%

Source: SharePad

10.6 times and offer a prospective dividend yield – which assumes a further special dividend this year – of 7.4 per cent. Debt levels are comfortable.

I can think of worse homes for your money but am not convinced in the long-term prospects of this business and its ability to generate enough sustainable free cash flow to fund lots of special dividends in the years ahead.

## JD Sports Fashion (LSE:JD.)

Can anything stop the relentless march of JD Sports? It continues to crank out great results year after year. Its profit before tax has increased from just over £100m in 2015 to £355m in the year to February 2019.

This company is doing well because it has been excellent at connecting with its customer base, unlike rivals such as Sports Direct. That said. It seems as if growth in its sports fashion business in the UK is slowing slightly after many years of stellar performance and that going forward, its investments in Europe, Asia-Pacific and the US are going to have to pick up the growth baton.

## JD Sports (LSE:JD.)



Source: SharePad

In this respect, things are looking good. Sports Fashion like-for-like (LFL) sales increased by 6 per cent last year with double-digit growth rates in Europe and Asia-Pacific. This has nicely complemented 39 new stores in Europe and 34 in Asia-Pacific.

I was initially sceptical about JD's purchase of Finish Line in the US last year. I thought it may have paid too much for a struggling business in a cut-throat market. Now, I feel a bit more optimistic about it given the update on the business in the results press release.

Finish Line actually had a decent year's trading performance with like-for-like sales growth of 7 per cent. That said, JD thinks that this business is capable of improving significantly. The stores still do not have JD's full complement of clothing brands whilst the company sees plenty of opportunities to improve sales and profit margins with the following actions:

- Improving sales densities and reducing the hit to profits from sales markdowns.
- Improving the buying of stocks.
- Exiting underperforming stores.
- Slimming down central overheads.

If the company can be successful in achieving these aims, then I think that it stands a decent chance of making a good return on its US investment.

The only blot on the results was the poor performance of the outdoor brands, Blacks and Go Outdoors where mild autumn and winter weather saw the business move from a profit of £8.8m to a loss of £4.3m.

The financial performance of the business remains reasonable. Cash conversion remains good but note that the company continues to invest significant amounts of money in inventories (stocks). This can be something to worry about if the stocks are not sold and then have to be reduced in price to sell them off. Recent experience suggests that JD is managing this risk well.

### JD Sports Fashion consolidated statement of cash flows

**Consolidated Statement of Cash Flows**  
For the 52 weeks ended 2 February 2019

	52 weeks to 2 February 2019 £m	53 weeks to 3 February 2018 £m
<b>Cash flows from operating activities</b>		
Profit for the period	264.2	236.4
Income tax expense	75.7	58.1
Financial expenses	7.5	2.0
Financial income	(1.2)	(0.6)
Depreciation and amortisation of non-current assets	115.0	71.3
Forex losses on monetary assets and liabilities	2.5	2.2
Impairment of other intangibles and non-current assets	11.9	5.1
Loss on disposal of non-current assets	2.0	1.6
Other exceptional items	7.2	1.3
Impairment of goodwill and fascia names	8.1	11.6
Increase in inventories	(26.2)	(79.0)
Increase in trade and other receivables	(22.5)	(22.1)
Increase in trade and other payables	21.2	110.7
Interest paid	(7.5)	(2.0)
Income taxes paid	(80.3)	(57.8)
<b>Net cash from operating activities</b>	<b>377.6</b>	<b>338.8</b>

Source: JD Sports Fashion

## JD Sports Fashion forecasts

JD Sports Fashion PLC (JD.)

### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	4,587.2	+45.1%	5,504.7	+20.0%	5,944.8	+8.0%
EBITDA	463.5	+20.3%	519.9	+12.2%	580.2	+11.6%
EBIT	353.3	+18.7%	417.5	+18.2%	467.2	+11.9%
Pre-tax profit	350.1	+18.4%	392.6	+12.1%	436.9	+11.3%
Post-tax profit	271.8	+11.0%	304.2	+11.9%	338.1	+11.1%
EPS (p)	27.8	+10.3%	31.3	+12.6%	34.9	+11.5%
Dividend (p)	1.8	+10.4%	2.0	+11.1%	2.4	+20.0%
CAPEX	175.6	+1.1%	199.9	+13.8%	214.4	+7.3%
Free cash flow	171.1	+9.1%	209.3	+22.3%	258.4	+23.5%
Net borrowing	-74.2		-243.1		-449.1	
NAV	995.8	+29.3%	1,273.9	+27.9%	1,574.7	+23.6%
Like for like sales growth %	4.0		7.0	+75.0%	7.5	+7.1%

Source: SharePad

At the moment, I'd say the outlook looks pretty good for JD Sports. Underlying sales and profit momentum look good while it has two acquisitions, in the form of Finish Line in the US and Footasylum in the UK, where profit margins can be enhanced significantly.

At 564p, the shares trade on a 2020 forecast PE of 18 times, which is by no means a bargain. However, if it can keep on delivering then the shares could still do very well from here.

## Galliford Try (LSE:GFRD)

I am a firm believer that one of the keys to better investment performance from a portfolio of shares is to avoid bad companies. Some sectors have a habit of throwing up lots of bad companies which suck in unwary investors with the promise of a big dividend yield or some other measure of cheapness. It often ends badly.

Over the past few years one sector that has proven to be a graveyard for investors has been construction. Staying away from construction companies has been a good thing to do. I've always struggled to see the attraction in them in any case. They have wafer-thin profit margins and are

## Galliford Try (LSE:GFRD)



Source: SharePad



incredibly opaque to the extent that even people on the inside of a company don't know what's going on with them until something bad happens. Cash flows tend to be moving about all over the place and can confuse investors.

Galliford Try has form in this area and has been struggling with its construction business for a few years now. Last year it tapped shareholders for fresh money as the cash balances in its construction business had declined rapidly due to problem contracts.

This week, that decision looked to be a classic case of throwing good money after bad. The company announced that it was slimming down its construction business. This is a good thing to do but it is going to be very costly. Post-tax profit forecasts for 2019 are set to come down (from £150m) by between £30-£40m as bad contracts are realised.

Unsurprisingly the share price tanked on this news. However, the company did try and reassure investors by saying that the decision would not affect its expectations for average net debt for the year with the hope of playing down fears that another rights issue might be needed. This seems a bit strange to me as either the cash effects of this contract were already known and not disclosed or the company has found some way of offsetting it. Or it could be there are no cash effects at all.

Shareholders will undoubtedly be very angry about this latest episode from what seems to be an error-strewn company. However, I can't help thinking that this latest mishap may flush out a bidder for the company's prized asset – housebuilder Linden Homes. Whether a bidder could cherry pick without taking on the construction business remains to be seen.

Not a share for those with a nervous disposition.

## Galliford Try forecasts

### Galliford Try PLC (GFRD)

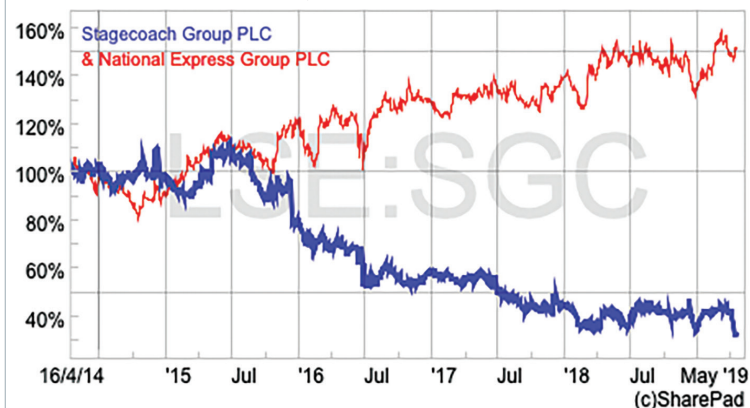
#### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	2,772.5	-5.4%	2,843.4	+2.6%	2,981.0	+4.8%
EBITDA	198.3	+17.9%	200.1	+0.9%	218.3	+9.1%
EBIT	191.6	+19.0%	193.2	+0.9%	207.0	+7.1%
Pre-tax profit	184.5	+28.4%	183.2	-0.7%	203.5	+11.1%
Post-tax profit	150.8	-2.5%	149.2	-1.1%	166.3	+11.5%
EPS (p)	136.6	-13.4%	137.6	+0.7%	152.6	+10.9%
Dividend (p)	68.6	-7.5%	68.9	+0.4%	76.4	+10.9%
CAPEX	6.0	+29.7%	6.2	+3.7%	8.6	+39.5%
Free cash flow	29.4	+5.2%	124.7	+324.8%	111.2	-10.8%
Net borrowing	177.4		107.3	-39.6%	147.9	+37.9%

Source: SharePad

## Stagecoach/National Express



Source: SharePad

## Stagecoach/National Express

I spent around half of my working life as a professional analyst covering transport companies. Bus and rail companies such as National Express and Stagecoach were part of my portfolio. These companies spent quite a bit of time copying each other. First they started in buying out privatised UK bus businesses, then they went into rail and then they went to America. For long-term shareholders it has been a very bumpy ride.

Rail franchises used to be a good source of profits for these businesses in the first decade after privatisation (1996-2006) but these days they seem to have become a liability. 10 years ago, National Express' very existence was questioned due to a botched contract to run the East Coast franchise. It is now out of UK rail entirely.

The same East Coast franchise also scuppered Stagecoach in 2017 when it realised it could not generate enough revenues to make good on the promised payments to the government. Many think that Stagecoach was very fortunate to still be considered a reliable bidder and operator of rail franchises after this. Last week, it seems that its luck ran out.

Stagecoach's bids for the East Midlands, South East and West Coast franchises were rejected by the government. The main reason cited was its refusal to fund the pension scheme of railway workers which currently has a big deficit. Given that Stagecoach currently operates the East Midlands and West Coast – with Virgin – franchises this is a sizeable hit to its profits and its share price has fallen sharply.

The company is now essentially left with a UK bus business which isn't growing that much. As a result, its profits are now firmly on a downwards path according to forecasts by City analysts.



## Stagecoach (SGC) forecasts

### Stagecoach Group PLC (SGC)

#### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	2,292.6	-35.0%	1,582.9	-31.0%	1,380.3	-12.8%
EBITDA	299.4	-10.5%	238.1	-20.5%	225.6	-5.2%
EBIT	167.3	+23.6%	131.5	-21.4%	113.5	-13.7%
Pre-tax profit	138.3	+35.2%	106.0	-23.3%	85.9	-18.9%
Post-tax profit	115.7	-9.6%	91.7	-20.8%	73.6	-19.7%
EPS (p)	20.2	-9.0%	15.4	-23.8%	12.9	-16.2%
Dividend (p)	7.6	-1.3%	7.6	0.0%	7.6	0.0%
CAPEX	118.5	-9.1%	130.7	+10.3%	135.2	+3.4%
Free cash flow	73.8	+18.8%	56.6	-23.3%	55.0	-2.8%
Net borrowing	344.9	-15.0%	325.0	-5.8%	320.1	-1.5%

Source: SharePad

However, I do wonder if Stagecoach shares have fallen a bit too much. At 118p, they trade on a 2021 forecast PE ratio – on much lower profit than currently – of 9.2 times and a dividend yield of 6.4 per cent. Bus businesses tend to be very cash generative and so the dividend should be affordable. The key risk is that pressures to regulate some or all of the UK bus industry intensify and reduce its profits further.

National Express, on the other hand, has been quietly getting on with running its portfolio of bus and coach businesses in the UK, Spain and the US and doing it well. Its decision to get out of UK rail has been a very wise one. Its steady growth without it has seen its profits, dividends and share price move up over the past few years.

I think there's a lot to like about this company. Long distance coach travel in the UK and Spain and school buses in the UK may not be the most exciting businesses out there, but they are very steady and reliable and generate lots of free cash flow.

Last week it bought a majority stake in a US employee shuttle bus business which continues its strategy of growing its non-school bus business. It has paid a reasonable

## National Express (NEX) forecasts

### National Express Group PLC (NEX)

#### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	2,591.0	+5.7%	2,705.7	+4.4%	2,793.9	+3.3%
EBITDA	441.3	+4.5%	460.5	+4.3%	472.5	+2.6%
EBIT	265.2	+9.8%	279.2	+5.3%	287.4	+2.9%
Pre-tax profit	233.6	+20.2%	247.6	+6.0%	256.8	+3.7%
Post-tax profit	178.5	+6.2%	189.4	+6.1%	195.3	+3.1%
EPS (p)	34.7	+5.8%	36.7	+5.8%	38.1	+3.8%
Dividend (p)	16.0	+7.7%	17.2	+7.5%	18.1	+5.2%
CAPEX	178.3	+7.1%	184.6	+3.5%	189.7	+2.8%
Free cash flow	181.9	+30.1%	203.6	+11.9%	216.1	+6.2%
Net borrowing	977.7	+0.7%	888.8	-9.1%	793.9	-10.7%

Source: SharePad

price which suggests it should have a decent chance of getting a reasonable return from this deal, as well as a platform for future growth.

I see National Express as a very solid and defensive income share. At 410p it offers a prospective March 2020 dividend yield of 4.2 per cent, with the prospect of decent dividend growth on top.

#### **WH Smith (LSE:SMWH)**

I think WH Smith is a very well managed business. Its Travel retail business is an attractive growth business which has the potential to offset the decline in the company's UK high street business and keep profits and dividends growing in the year ahead. I did a detailed analysis of the Travel business in the magazine a couple of weeks ago and very much like the look of it.

Half-year results last week continued the trend of the past few years. High Street profits were down by 4 per cent but Travel profits were up by 7 per cent. After central costs, total group operating profits were flat. However, while the high street benefitted from Christmas trading the Travel business will have its peak profitability during the second half of the year in the summer.

The UK travel business is doing well with only rail sites being slightly sluggish due to engineering works. Sales growth at airports was ahead of passenger growth. The company is very bullish on the outlook for its Hospital business, which will become its second biggest source of revenue in the UK after airports this year.

It currently has 133 units in UK hospitals, but believes that it can have as many as 300. It is a business that has very attractive characteristics, as along with its captive customer base, hospital visitors are not cyclical like those at airports or railway stations.

The company is on course to open 20 units in the UK

#### **WH Smith (LSE:SMWH)**



Source: SharePad

## WH Smith channels and revenues

Channel	Total revenue	LFL revenue*
UK Air	5%	4%
UK Hospital	11%	4%
UK Rail	- %	1%
International (inc InMotion)	76%	4%

Source: WH Smith

this year. This includes some trial pharmacy formats within its stores which could bring another useful source of revenue.

Overseas, things are also going very well. Twenty-one new tenders have been won including four with the InMotion technology format, of which two were outside the US in Spain and Australia. WH Smith is confident that it can add 20-30 formats a year. When combined with solid like-for-like sales growth driven by increased air travel, the outlook for the business continues to look favourable.

WH Smith shares are up 23 per cent so far this year and trade on a one year rolling forecast PE of 17.4 times, at a share price of 2,116p. I think the shares have good long-term potential, but may pause for breath for a while.

## WH Smith (SMWH) forecasts

### WH Smith PLC (SMWH)

#### FORECASTS

£ millions unless stated

Year	2019		2020		2021	
Turnover	1,385.1	+9.8%	1,441.1	+4.0%	1,500.0	+4.1%
EBITDA	207.0	+12.5%	221.1	+6.9%	235.3	+6.4%
EBIT	160.2	+13.6%	171.8	+7.3%	182.9	+6.4%
Pre-tax profit	155.0	+11.5%	166.9	+7.7%	177.9	+6.5%
Post-tax profit	126.9	+6.6%	134.4	+5.9%	143.7	+7.0%
EPS (p)	116.2	+7.4%	126.2	+8.6%	136.7	+8.3%
Dividend (p)	57.6	+6.5%	62.9	+9.2%	68.6	+9.1%
CAPEX	59.8	+12.7%	56.1	-6.0%	56.9	+1.3%
Free cash flow	98.3	+9.2%	128.4	+30.7%	137.8	+7.3%
Net borrowing	161.8	+7987.7%	129.8	-19.7%	105.4	-18.8%

Source: SharePad

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