Investors' Chronicle | Alpha

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Anti-hedge fund vigilantes cap a strange week

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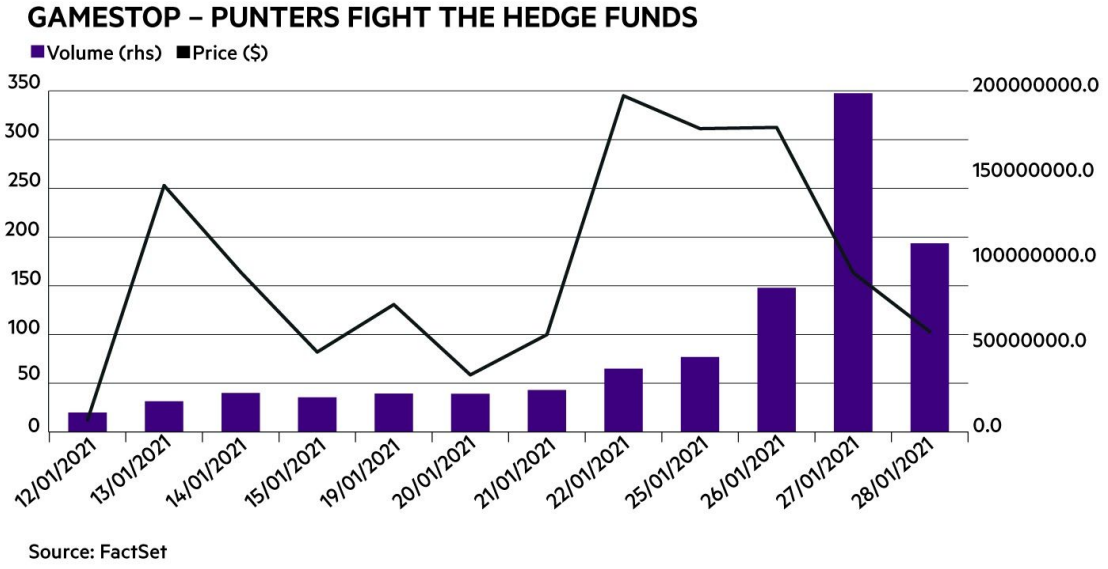
Retail investors fight Gamestop short sellers

This has been a very strange week. Instead of people focusing on the outlook for company profits and the economy, the attention has been on a loss-making video games company called Gamestop and other shares that have been heavily shorted by hedge funds.

Report by Phil Oakley



Gamestop shares are up by nearly 1,000 per cent in the past month and by 4,670 per cent in the past year. The business is forecast to make pre-tax losses of $170m in the year to October 2021 and is currently valued by the stock market at $13.8bn.

I can see why people might think Gamestop is overvalued, but we are not living in a world where loss-making businesses with high stock market valuations are uncommon. If you lived and worked through the late 1990s tech and media bubble, then what's going on with Gamestop will be nothing new to you and it is something that is part and parcel of markets from time to time.

However, the message from this week's goings on is a serious one and one that we should all be concerned about. I'm not talking about the so-called democratisation of finance, as private investors have been able to freely buy speculative shares and win and lose from them for years.

I also have no doubt about the intentions of coordinated attempts by groups of people on the Reddit website to inflict pain on hedge funds who have bet on shares to fall in price. By buying the likes of Gamestop and pushing the price up, they have inflicted severe pain on some funds and forced them to close their bets as they could not afford to meet the margin calls – the money needed to cover their losses.

I can understand why people dislike hedge funds. I will freely admit that I'm no fan of them myself. They are homes to very smart people, but I'm not convinced that they actually make anyone other than themselves better off.

The hedge fund fee structure of 2 and 20 (2 per cent annual fee based on the value of the portfolio and 20 per cent of the gains made) has allowed hedge fund managers to be obscenely rewarded with some of them assuming very high profiles with ostentatious shows of their wealth.

The term hedge is often somewhat of a misnomer as many funds do not seem to hedge their portfolios. Instead they tend to make large speculative bets with other people's and borrowed money. The results have generally been unspectacular with Warren Buffett easily winning a bet that a S&P 500 index fund would beat the returns of the hedge fund industry.

I always remember the comment made by an old colleague from my stockbroking days, who told me of the question that was apparently asked by the customer of one of

London's most prominent hedge funds in the early 2000s: "How much are we paying for leverage?"

However, the serious matter about all this week's events is the apparent real threat of the hedge fund industry to destabilise financial markets. The pain inflicted by the Gamestop short squeeze has led to speculation that the funds will have to sell their more liquid positions to cover their losses and bring the market crashing down.

In many ways, nothing has been learned over the years. For decades, the road to riches for the selected few has been to invest with lots of borrowed money. If the gamble pays off then extreme wealth has been pocketed but if it goes wrong then it is someone else's problem. This is not just an issue for the big players in the City and on Wall Street, but has also been adopted by smaller private investors who have borrowed to speculate in the stock market via spread betting accounts or apps like Robinhood.

I understand and agree with people who are angry about this and think it's time to bring in more limits on leverage and speculation. On a more general note, the message that people can just get rich trading shares and not working for a living is not a healthy one for the long-term prospects of an economy and society as a whole.

The stock market has always had casino-like characteristics and always will. I've said for some time that parts of the market are too frothy, but I also retain the view that other parts are not.

We have experienced prolonged periods of share prices decoupling from company profits and it's hard to see this as sustainable. This week's events may well be the start of a healthy correction that is long overdue and genuine long-term investors should not be afraid of this but welcome it instead.

UK Quality shares vs comparators

Portfolios % returns	1 month	Year to date	1 year	2 years	3 years
Vanguard FTSE 100 ETF	-0.2	0.5	-10.6	4.1	-4.3
FTSE All-Share - Total Return	-0.3	0.2	-8.8	6.3	-2.3
Phil Oakley UK Quality Shares	**-0.4**	**-1.0**	**-4.0**		
Castlefield CFP SDL UK Buffettology	-1.9	-1.6	1.5	26.4	32.2
Baillie Gifford UK Growth	-1.3	-1.8	13.1	32.6	28.8

Fund					
Vanguard FTSE 250 UCITS ETF	-2.5	-2.1	-4.7	12.8	3.8
Finsbury Growth & Income Trust	-1.6	-2.6	-2.0	17.0	18.6

Source: SharePad

Fantasy Sipp vs comparators

Portfolio % returns	1 month	Year to date	1 year	2 years	3 years
Scottish Mortgage Investment Trust	4.9	2.1	112.0	166.0	165.0
iShares NASDAQ 100 UCITS ETF	2.2	1.2	37.0	89.8	96.6
Vanguard S&P 500 ETF	0.9	0.5	10.6	42.0	42.9
iShares MSCI World Acc	0.4	0.0	9.3	35.2	31.4
Mid Wynd International Inv Trust	0.3	-0.6	16.6	50.8	42.3
Martin Currie Global Portfolio Trust	1.5	-0.8	16.6	58.0	53.9
Fundsmith Equity T Acc	-2.5	-2.4	12.8	43.9	47.3
LF Blue Whale Growth Fund	-2.8	-3.4	18.0	51.7	54.2
Phil Oakley Fantasy Sipp	**-2.4**	**-3.5**	**4.4**	**39.4**	**44.8**
Smithson Investment Trust	-3.2	-3.9	24.9	59.2	
Lindsell Train Investment Trust	-2.5	-7.4	12.5	9.1	70.8

Source: SharePad

Companies round-up

The six companies this week are:

- Tesla
- Apple
- Microsoft
- Diageo
- Fevertree
- Boohoo

Tesla

Tesla (TSLA) is a company that divides opinion and is responsible for many column inches in the financial media. To some it is a visionary, revolutionary company with a technological edge that will allow it to dominate the market for electric vehicles and create huge amounts of wealth for its owners.

To others with a more sceptical view, it is a symbol of frothy overexuberance, which faces up to the challenging economics of a global car industry where making consistent and meaningful profits is very hard to do.

I have sympathies with both points of view. I don't dispute that Tesla has a technological edge right now and also has the benefit of not carrying the burden and the costs of a legacy business built on the internal combustion engine. But I also think that to call it a technology business is stretching things somewhat. To me, it is very clear that it looks like and is a car company, albeit a slightly different one to most of the industry.

The other thing that is also indisputable is that its status as a considerable wealth creator has already been taken for granted. As I write this, the company has a market capitalisation of $784bn which, for a company that has only just posted its first annual operating profit, looks to be more than generous.

A lot is talked about its battery storage and solar business as a source of value creation, but at the moment Tesla is making no money from it. If we are looking for the real source of future value creation – which the stock market looks to have already priced in and then some – then it's all about the automotive side of the business.

Tesla: Gross profit by division

Gross profit $m	2016	2017	2018	2019	2020
Automotive	1601	2209	4341	4423	6977
Generation & storage	3	242	190	190	18
Services & other	-5	-228	-489	-544	-365
Total gross profit	1,599	2,223	4,042	4,069	6,630

Source; Annual reports/Investors' Chronicle

2020 was a good year for the company. Total deliveries were up by just under 35 per cent to just under half a million. Compare this with Toyota which had annual deliveries of nearly 9m vehicles in 2020 and has a market capitalisation of around a quarter of Tesla's.

Tesla's revenues increased by 28 per cent, with operating profits of nearly $2bn at a margin of 6.3 per cent (Toyota's margin last year was 8.2 per cent). This is a big improvement in profitability, but some care is needed interpreting this. 2020 saw a big increase in regulatory credit revenue – emissions credits that Tesla earns for selling zero emission vehicles and sells to other companies who need to pay for their pollution – of nearly $1bn, which my guess is largely a pure source of profit. Without these, the economics of the business would not be as good.

Tesla: Key numbers and car deliveries table

$m	2016	2017	2018	2019	2020
Automotive revenues	6351	9642	18515	20821	27236
o/w regulatory credits	*302*	*360*	*419*	*594*	*1580*
Generation & storage	181	1116	1555	1531	1994
Services & other	468	1001	1391	2226	2306
Total revenues	7000	11759	21461	24578	31536
Gross profit	1599	2223	4042	4069	6630
Operating profit	-667	-1632	-388	-69	1994
Gross margin	22.8%	18.9%	18.8%	16.6%	21.0%
Operating margin	-9.5%	-13.9%	-1.8%	-0.3%	6.3%
Reg credits as % of Auto revenue	4.8%	3.7%	2.3%	2.9%	5.8%
Deliveries	2019	2020	% change	2021F	2022F
Model S/X	66,771	57,039	-14.6%	72,000	58,700
Model 3/Y	304,525	442,511	45.3%	704,700	1,093,100
Total deliveries	371,296	499,550	34.5%	776,700	1,151,800

Source: Annual reports/factSet

The company remains very bullish about its outlook. Its Shanghai factory is performing well and vehicle production will commence from its new factories in Austin, Texas, and Berlin this year, which will produce the Model Y SUV and the Model 3.

Tesla is confident that it can achieve annual growth in deliveries of more than 50 per cent for the next few years and will grow at a faster rate than that in 2021. It has also made significant progress on its full self driving software. When and to what extent this is monetised remains to be seen. The Tesla Semi truck continues to be delayed until Tesla is capable of making its own batteries for it.

If Tesla is going to be successful, then it is going to have to continue selling a lot more Model 3s and Ys (an SUV that is based on the Model 3) which currently start off at around the £40,000 to £45,000 mark in the UK. The S and X models are approaching and more than £100,000 to buy, respectively.

This is not cheap by any means and is firmly competing for the custom of drivers who drive premium German brands. There's no doubt that the range and performance of these cars is already pretty good, but the interiors seem somewhat bland and underwhelming to me if you are used to the plushness of an Audi, BMW or Mercedes. Tesla also suffers from the lack of the now ubiquitous Apple Car Play and Android Auto and sells its own infotainment software instead.

The cars also have a patchy reputation for build quality and customer service (the industry in general, perhaps with the exception of Toyota, does not have a great reputation for service), which will hopefully get better but is not a source of competitive edge given the developments from the brands they are trying to displace.

At the cheaper end of the market, the Toyota Prius has been around for years and has a solid reputation, while newer entrants such as the Renault Zoe, Kia eNiro and Volkswagen's ID 3 seem to be good options. The newly launched Volkswagen ID 4 SUV parks itself in Tesla's Y playground with a slightly cheaper price (c£40k) and similar battery range. Chinese electric cars are making great progress with brands such as Nio which plans to come to Europe in the next five years.

Electric vehicles are definitely the future, but that does not mean that we should blindly accept that companies in this sector are automatic winners. The airline sector is a classic historical example of how a growth industry destroyed huge amounts of value. The automotive sector's history is hardly cause for comfort given that all the big players are betting big on electric and they probably all can't win by creating an economic moat.

The problem with Tesla is that a successful outcome is priced in. Its absurd valuation –175 times forecast earnings – is symptomatic of sections of the stock market where the story is all important and valuations irrelevant. Ignoring valuation has served long-term investors in Tesla well, but my view is that it cannot be ignored for ever and last year's stellar gains delivered a lot of the value of currently uncertain future profits upfront.

Tesla: Current forecasts

Year $m	2020	2021	2022
Turnover	30,945.10	45,802.70	58,887.80
Ebitda	5,913.60	9,127.40	12,664.80
Ebit	2,464.00	4,593.50	7,153.30
Pre-tax profit	3,015.40	6,158.10	8,584.90
Post-tax profit	2,596.10	4,476.70	7,066.60
EPS (¢)	247.1	431	678.4
Dividend (¢)	-	-	-
Capex	2,893.40	4,319.30	4,278.20
Free cash flow	1,859.00	2,638.50	3,936.10
Net borrowing	-5,309.80	-7,275.80	-13,527.10

Source: SharePad

The company beat analysts' expectations for revenue in the fourth quarter of 2020 and it looks as if delivery forecasts will probably move up. But the company missed on profit forecasts and when you have a valuation as frothy as Tesla this can't be tolerated forever on the basis of the long-term story.

If we get a long overdue return to sanity on the valuation of growth businesses then Tesla shares look very exposed.

Apple

Apple's (US:AAPL) first-quarter results were excellent. The iPhone 12 has clearly been well received by consumers, while the sales of iPads and Macs show that Apple has been a big beneficiary of the work from home and home schooling that is likely to persist for a while.

Apple now has 1.65bn active devices worldwide, including more than 1bn iPhones. This is an impressive user base of very sticky customers who are unlikely to gravitate to competitors and can be sold additional services. This is what makes Apple one of the world's most valuable companies.

From my own recent experience, iPad availability in the UK is very low with most retailers currently sold out and Apple's own store having delivery times of three to four weeks on many models.

As a user of many Apple products, my view is that their value for money is getting better as new iPads and Macbooks seem to be closer in price to competitors' than they have been for some time.

Apple: Q1 revenue

$bn	Q120	Q121	% change
iPhone	56.0	65.6	17.2%
iPad	6.0	8.4	41.1%
Mac	7.2	8.7	21.2%
Services	12.7	15.8	24.0%
Wearables	10.0	13.0	29.6%
Total	91.8	111.4	21.4%

Source: Apple

The Services business is doing extremely well. Apple now has 620m paid subscribers (140m more than a year ago) to services such as Apple Music, iCloud, Fitness + and its Apple One bundles, while its App Store continues to perform well.

Wearables such as the Apple Watch, Airpods and HomePod speakers are also selling extremely well.

Apple is in very rude health and looks set to keep on making progress. I think the company's push on the privacy aspect of its devices is a long-term winner. People have become more aware as to how much social media and internet search engines are making from them as well as being conscious of the risk of identity theft and fraud.

I continue to have some sympathy with the view that the company remains too reliant on the iPhone – 50 per cent of total sales – but that dependency has come down from over 65 per cent of revenues in 2015. The success of wearables and homepods and the integration with Services is a very strong growth driver right now and underscores the strength of Apple's ecosystem.

This business strength continues to produce very strong financial performance metrics. Apple's margins, return on capital employed (ROCE) and free cash flow generation remain prodigious. The company continues to use its free cash flow and cash pile to repurchase shares which still underpins the share price at low interest rates.

Apple: Key performance indicators

Apple ($bn)	2014	2015	2016	2017	2018	2019	2020	TTM
Revenue	182.8	233.7	215.6	229.2	265.6	260.2	274.5	297.1
Gross profit	70.5	93.6	84.3	88.2	101.8	98.4	105.0	114.1
Op profit	52.5	71.2	60.0	61.3	70.9	63.9	66.3	74.3
Profit after tax	39.5	53.4	45.7	48.4	59.5	55.3	57.4	63.9
Capital employed	174.7	212.2	246.2	281.0	258.6	243.1	232.3	234.3
Capex	9.6	11.2	12.7	12.5	13.3	10.5	7.3	8.7
Free cash flow	50.1	71.0	53.1	51.8	64.1	58.9	73.4	80.2
Total debt	35.3	55.8	78.9	103.7	102.5	102.1	112.4	112.0
Cash	155.2	205.7	237.6	268.9	237.1	205.9	191.8	195.6
Dividend paid	11.1	11.6	12.2	12.8	13.7	14.1	14.1	14.2
Share buybacks	45.0	35.3	29.7	32.9	72.7	66.9	72.4	76.4
Gross margin	38.6%	40.0%	39.1%	38.5%	38.3%	37.8%	38.2%	38.4%
Op margin	28.7%	30.5%	27.8%	26.8%	26.7%	24.6%	24.1%	25.0%
ROCE	30.1%	33.6%	24.4%	21.8%	27.4%	26.3%	28.5%	31.7%
FCF margin	27.4%	30.4%	24.6%	22.6%	24.1%	22.6%	26.7%	27.0%
FCF conv	126.8%	133.0%	116.2%	107.1%	107.7%	106.6%	127.8%	125.5%
Debt to FCF	0.7	0.8	1.5	2.0	1.6	1.7	1.5	1.4
Div & BB as % of FCF	112.0%	66.1%	78.9%	88.2%	134.8%	137.5%	117.8%	112.9%
Capex to sales	5.24%	4.79%	5.89%	5.45%	5.01%	4.04%	2.66%	2.93%

Source: Annual reports/Investors' Chronicle

The company did not give any revenue guidance for the second quarter, but full-year forecasts for the year to September 2021 look very doable to me. The current annual run rate of net income is currently $63.9bn, while the current consensus of Wall Street analysts is $67.6bn.

At $141, the shares trade on a one-year rolling forecast PE of 34.4 times. That looks quite justifiable for a business as good as Apple.

Apple: Current forecasts

Year $m	2021	2022	2023
Turnover	318,773.80	333,496.70	347,709.80
Ebitda	91,959.80	95,954.80	99,476.50
Ebit	80,221.60	84,295.00	86,294.60
Pre-tax profit	80,760.20	84,683.80	88,482.10
Post-tax profit	67,601.40	70,714.20	72,919.20
EPS (¢)	402.1	434.6	461.7
Dividend (¢)	84.7	91.3	101.9
Capex	10,508.40	10,800.50	10,934.30
Free cash flow	74,641.80	82,117.10	84,659.20
Net borrowing	-90,235.70	-120,841.10	-197,050.00

Source: SharePad

Microsoft

When explaining his preference for the shares of smaller companies, legendary fund manager Jim Slater said "elephants don't gallop". By this he meant that it was difficult for companies that were already big to get proportionately much bigger.

I think this rule works most of the time, but Apple is currently proving to be an exception to it and so is Microsoft.

Microsoft's (MSFT) second-quarter numbers released this week were very strong with revenues up by 17 per cent to $43.1bn and operating profits growing by 34 per cent to $17.9bn.

The star performer was again its commercial cloud business where revenues increased by 34 per cent to $16.7bn. Its Azure cloud infrastructure business saw revenue growth of 50 per cent.

Microsoft has built a very strong competitive position based on the cloud, which also complements its very large servers business. It has an established and trusted brand combined with the financial fire-power to invest and offer a global service to companies.

When this is combined with a dominant cloud-based software such as Microsoft Office 365 and business management software such as Microsoft Dynamics 365, the company has an enviable portfolio of assets and products to exploit the continued potential of the shift away from physical ownership of hardware to renting it through the cloud.

Remote and home-working is served brilliantly with its software as companies and workers are currently experiencing with video conferencing software such as Microsoft Teams, which is integrated into Microsoft Office 365.

Elsewhere, Windows revenues were broadly flat but XBox saw sales growth of 40 per cent as the new console has been a big hit with gamers. Linkedin continued its strong recent performance with growth of 23 per cent.

It is very likely that there has been some significant pull through of future cloud revenue over the past year, but it is unlikely to disappear. The gross margin on cloud revenues is more than 70 per cent and so contributes to higher profit margins overall for Microsoft.

Microsoft: Current forecasts

Year $m	2021	2022	2023
Turnover	163,876.10	180,694.70	202,590.70
Ebitda	77,487.60	85,619.10	96,807.30
Ebit	65,627.10	71,743.60	82,714.10
Pre-tax profit	66,545.00	72,450.90	83,071.60
Post-tax profit	55,996.40	59,870.70	68,845.70
EPS (¢)	735.9	792.1	917.9
Dividend (¢)	220.2	237.9	268.5
Capex	18,906.60	21,243.30	23,018.30
Free cash flow	52,385.20	58,218.70	64,437.10
Net borrowing	-71,454.90	-108,716.80	-154,974.90

Source: SharePad

The company is very upbeat about its full-year outlook. It expects double-digit revenue growth with profit margin expansion.

This fits well with the current expectations of Wall Street analysts. I'm not too sure if there will be big forecast upgrades as current rolling one year revenues of $153bn and operating profit of $60.1bn still give the company some work to do, but not so much that forecasts cannot be beaten.

This is a business that I feel very comfortable with in the Fantasy Sipp. On just over 30 times one-year rolling forecast EPS at a share price of $242, I don't feel that the business is excessively valued given its competitive positioning, quality and growth potential.

Diageo

Diageo (DGE) has not been having an easy time due to Covid-19 lockdowns. Last year it was one of the first companies to report the impact on its profits from the closure of bars and hotels in China and the fall off in airline passenger numbers. These are areas where Diageo makes richer margins on a business that is already very profitable most of the time.

The company has a fabulous portfolio of global spirits brands with increasing premiumisation. They have stood the test of time very well and are also a small play on the luxury sector and the growing affluence of the middle class in Asia.

This week's half-year results were very reassuring and showed that Diageo has a high degree of resilience in these tough times. Net sales were down by 4.5 per cent to £6.9bn, while adjusted operating profit fell from £2.5bn to £2.25bn. The fact that the business can still produce operating margins of 32.7 per cent in times like this shows its strength

and durability and why it is seen as a steady and dependable investment for so many investors. It even increased its half-year dividend by 2 per cent.

Its North American business – its biggest and most important – was a star performer with organic revenue up 12.3 per cent. Don Julio Tequila sales were very strong, while Johnnie Walker, Ciroc Vodka, Bulleit bourbon and Tanquray gin also showed good growth. The business also had a considerable tailwind from retailer restocking. Destocking and restocking is a regular feature of the spirits business and does have the potential to give rise to some volatile results from time to time. In the past six months it has favoured Diageo.

Elsewhere, results were more patchy. Sales in the UK off trade were strong, but Guinness sales have suffered a lot due to the closure of pubs and bars. Asia-Pacific profits increased marginally due to the strength of Chinese white spirit sales.

Overall Diageo has managed its costs well and there has been good discipline on its marketing expenditure.

The company is cautiously optimistic about the outlook for the second half of the year. It expects profit margins to grow in all areas apart from North America where it is up against a strong comparative period.

Diageo: Current forecasts

Year(£m)	2021	2022	2023
Turnover	11,909.30	12,740.30	13,331.30
Ebitda	4,014.80	4,433.90	4,763.00
Ebit	3,606.30	4,011.00	4,316.40
Pre-tax profit	3,417.30	3,878.00	4,235.00
Post-tax profit	2,625.70	2,962.10	3,194.00
EPS (p)	112.6	126.9	137.9
Dividend (p)	70.2	73.6	76.9
Capex	647.1	675.6	693.6
Free cash flow	2,641.60	2,623.10	2,976.30
Net borrowing	13,026.30	12,792.40	12,818.70

Source: SharePad

Debt levels remain quite high at 3.4 times net debt to earnings before interest, tax, depreciation and amortisation (Ebitda), which is ahead of its target range of 2.5 to 3.0 times. This is still likely to be the case at the end of its financial year in June and so share buy-backs remain suspended.

This is a company that I continue to like and feel happy to leave it to quietly chug away in both fantasy portfolios. At 2,943p, the shares trade on a one-year rolling forecast PE of 24.3 times, which looks okay for a leading global consumer brand business in the current market.

Fevertree

Like Diageo, **Fevertree (FEVR)** has suffered badly from the closure of pubs, particularly in the UK where they have been a big driver of its sales growth in recent years.

That said, the company has coped with the challenges it has faced really well with sales for 2020 not too far off what it achieved in 2019.

In the UK, on trade sales fell by 60 per cent, but off trade sales increased by 20 per cent as people still kept drinking their gin and tonics at home during lockdown. It remains the market leader by value in the off trade with 40 per cent of the market (Schweppes still sells more volume at a lower price).

Predicting the future of the UK business is not easy. There will be a shift in mix from the off trade back to the on trade when pubs reopen again but whether it can be a source of significant revenue growth in the future as it had in the past remains to be seen.

It has been a big beneficiary of the gin boom in the UK, but sales were already struggling to grow before the pandemic hit as second flag sales fell by over 5 per cent in 2019 and showed no growth for the year as a whole.

Fevertree sales and growth rates

FEVR sales (£m)	UK	Europe	USA	ROW	Total
2020	103.3	65.3	58.5	25.0	252.1
H2	55.0	44.8	31.1	17.0	147.9
H1	48.3	20.5	27.4	8.0	104.2
2019	132.7	64.4	47.6	15.8	260.5
H2	72.0	35.4	27.8	8.0	143.2
H1	60.7	29.0	19.8	7.8	117.3
2018	134.2	55.5	35.7	12.0	237.5
H2	76.2	29.8	20.6	6.7	133.3
H1	58.0	25.7	15.1	5.3	104.2
2017	87.8	44.7	29.5	8.1	170.2
H2	54.2	22.7	16.3	4.9	98.3
H1	33.6	22.0	13.2	3.2	71.9
2016	44.7	31.1	21.3	5.2	102.2
Growth rates	UK	Europe	USA	ROW	Total
2020	-22.2%	1.4%	22.9%	58.2%	-3.2%
H2	-23.6%	26.6%	11.9%	112.5%	3.3%
H1	-20.4%	-29.3%	38.4%	2.6%	-11.2%
2019	-1.1%	16.0%	33.3%	31.7%	9.7%
H2	-5.5%	18.8%	35.0%	19.4%	7.5%
H1	4.7%	12.8%	31.1%	47.2%	12.6%
2018	52.8%	24.2%	21.0%	48.1%	39.5%
H2	40.6%	31.3%	26.4%	36.7%	35.6%
H1	72.6%	16.8%	14.4%	65.6%	44.9%
2017	96.4%	43.7%	38.5%	55.8%	66.5%

Source: Annual reports/Investors' Chronicle

While Diageo's results show that gin sales are still growing, I think Fevertree will have to rely on other markets to drive its revenues and profit growth.

In this respect, the developments in the US are encouraging with 23 per cent revenue growth in the US in 2020 due to growth in off trade and sales over the internet. After a shaky start, Fevertree cut its prices and volumes have responded with 57 per cent growth in off trade sales. It's difficult to get a feel of momentum in this business given the pandemic, but sales growth slowed significantly in the second half of the year and this trend needs to be watched.

It is very good to see that Fevertree is now making its drinks in the US, having partnered with a bottling company on the West Coast. This will produce big savings in shipping costs as the company will no longer be reliant on supplying the market from the UK. It will also allow it to supply US customers faster. This is a good move that should help boost profits from the US.

Fevertree's European business is more skewed to the on trade and has therefore suffered a lot. It has been helped by retailer destocking unwinding and the revenues from its recent German acquisition. This helped sales grow marginally in 2020, but they would have fallen by nearly 9 per cent if it wasn't for the extra German revenues.

Sales growth in Australia and Canada has been really strong with Fevertree winning new distribution contracts. This helped the rest of the world sales increase by an impressive 58 per cent.

As in spirits, off-trade sales have lower margins attached to them than sales to pubs and bars. The change in sales mix caused by Covid-19 will see a reduction in Fevertree's Ebitda margins for 2020, but the strength in sales will mean that full-year profits are expected to be better than previously hoped for.

A strong recovery in profits is expected in 2021, but the company is not expected to exceed the profits it made in 2018 until 2022.

Fevertree: Current forecasts

Year (£m)	2020	2021	2022
Turnover	242	291.3	331.2
Ebitda	53.8	75.9	89.7
Ebit	48.9	70.7	84.1
Pre-tax profit	49.3	69.4	82.3
Post-tax profit	39.7	56.7	67.3
EPS (p)	34.1	49.3	58.5
Dividend (p)	15.1	17.9	20.2
Capex	2.4	2.7	2.9
Free cash flow	43.8	50.7	64.9
Net borrowing	-147.6	-178.2	-217.7

Source: SharePad

I think Fevertree is a good business and the shift in growth away from the UK is a very encouraging development and is close to removing one of my key concerns about the business. The valuation at 50 times one-year rolling forecast EPS at 2,497p remains a

little too rich for my liking, but I think investors should be encouraged with how the company is developing.

Boohoo

This week has seen two of the UK's most successful online fashion retailers try to capitalise from the misfortunes of old high street stalwarts. Asos has announced that it is in discussions with the administrators of Arcadia to buy the brands of Topshop, Topman, Miss Selfridge and HIIT, whereas **Boohoo Group (BOO)** has done a deal to buy the Debenhams.com online business.

This is an interesting move for the boohoo business. The cost of the deal, at £55m plus VAT, can be comfortably met from its current cash pile but whether this deal will make a meaningful difference to the company and its shareholders I'm not too sure about.

Debenhams is a well-known brand, but it is an old and tired one, in my view. That said, its website did have 300m visits last year and generated net revenues of £400m. Whether it made any money has not been disclosed.

I see this as a bit of a strange move for boohoo. While it has a good reputation for buying up small brands and integrating them into its existing business, this is a slight change in direction for the company.

Incredible success has been had by boohoo in selling inexpensive fashion to young people. It is now taking on a business that is well known for selling lots of make-up and beauty products to older customers, but one that has weak competitive positioning in fashion and homewares. However, I still think that there's a good chance that enough of its 6m beauty customers will buy make-up from Debenhams to help boohoo.

Boohoo's plan is to spend the next year redesigning the website – which means it will produce no revenues and incur some modest start up losses – before launching it in 2022.

Its ambition is to create the UK's largest online marketplace for its own fashion brand, Debenhams branded fashions, beauty products and homewares. It then wants to branch out to sell third party fashion, homewares and sports.

The marketplace concept is a good one and has been incredibly successful for companies such as Amazon and ebay, as well as fashion companies such as Asos and Next. I think boohoo can make a reasonable return on its investment here, but I am not convinced that it can take a lot of market share in sports and homewares where established businesses will be hard to compete with.

I see this as a modestly accretive deal for boohoo rather than a game changer, but welcome nonetheless. The shares are still under a cloud regarding the provenance or otherwise of its supply chain, but I think it is a business with good long-term prospects. On just over 31 times rolling forecast EPS, I think the shares are attractively valued for the growth the company offers.

Boohoo: Current forecasts

Year (£m)	2021	2022	2023
Turnover	1,714.50	2,146.50	2,693.30
Ebitda	163.7	200.4	251.7
Ebit	138.1	167.6	209.1
Pre-tax profit	140.2	171.5	215
Post-tax profit	110	140.9	176.9
EPS (p)	8.5	10.7	13.7
Dividend (p)	-	-	-
Capex	89.4	96	133.4
Free cash flow	104.3	107.8	131
Net borrowing	-324.2	-409.4	-521.6

Source: SharePad

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