Investors' Chronicle | Alpha

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Inflation fears could cause further market volatility

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Are policy makers being too complacent?

Investors are rightly starting to consider the impact of rising prices on the companies they buy shares in and their customers. Policy makers have the difficult balancing act of not allowing inflation to get out of control but also not to risk choking off recovery by raising rates too fast

Report by Phil Oakley

Is there too much complacency on inflation?

For me, the whole point of investing is to grow the buying power of your money so that it will buy more stuff tomorrow than it does today. This means that whatever you invest in has to grow in value faster than prices in general.

For the best part of 30 years, inflation has not really been a concern for UK investors apart from the odd spike in years such as 2011. This has made the task of beating inflation not as difficult as it was in the 1970s and 1980s.

Inflation has been subdued due to the powerful forces of globalisation, which has seen many manufacturing jobs outsourced to lower cost countries and the decline in the power of unionised labour to grow workers' wages.

Buying long-term government bonds has allowed investors to beat inflation without taking lots of risks up until relatively recently. Even as bond yields have fallen below the rate of inflation, bonds have done well as many people expected yields to keep on going lower and in some cases negative.

However, it is the price of shares that have been the main beneficiaries of low inflation and the low interest rates that have come with it as the real returns on offer with the prospect of growth on top quite rightly looked like the best deal on offer to investors. Even with the worst economic shock in living memory in the form of Covid-19, furious

money printing by central banks has kept interest rates low and pushed share valuations even higher, particularly in high quality growth stocks and technology stocks.

This trend has been compounded by the age old problem of career risk of professional US fund managers. Anyone who did not own tech during the last few years will have more than likely seriously underperformed the S&P 500 and seen their customers going elsewhere. This means just as we saw in the technology, media and telecom bubbles in the late 1990s, certain sections of the market became a crowded trade.

That said, I do not think what we have now is the same as back then as at least today the high valuations are attributed to excellent businesses that in many cases have large profits and plenty of cash flow.

However, we seem to have reached a point in the road when valuations matter again. This is because higher inflation will mean that the valuations of many shares will give yields that are less than inflation.

On Wednesday, the US inflation report said that the consumer price index for the year to April was 4.2 per cent which was more than the 3.6 per cent predicted by economists (as if they could predict it accurately anyway). This was the biggest jump since 2008 and has rightly worried investors.

The key issue is whether this is a temporary or permanent shift in prices. The so-called experts in the US Treasury and Federal Reserve have up until now said they think it's a temporary thing. I'm not so sure. It needs to be kept in mind that prices today are being compared with a brief period of severe economic depression last year and so some increase is actually easily explained.

I'm reading about lots of companies putting their prices up in areas such as consumer staples. Will these companies reduce them again when commodity price pressures cool off? They will if there is enough competition but many companies have a habit of being very quick to raise prices and very slow to cut them. My view is that some price rises will be permanent.

I expect UK inflation figures to show similar upwards pressure, but will it do that much damage to consumer purchasing power? The simple answer is yes in the short term, but as always it will affect poorer people more than the wealthy, as it always does.

Filling up a car with unleaded petrol at my local Tesco is £1.25 per litre compared with 99p around a year ago, but I remember paying £1.40 back in 2008 and so the current

cost is not unprecedented. This can be managed for the comfortably off, but for someone returning to work with a decent amount of commutable driving it is going to be noticeable. This of course is before everything that we buy that is delivered by road transport getting more expensive to cover deliverers' rising fuel costs as well.

Elsewhere, I hear of the price of restaurant meals (eaten outside) and bookings from Monday (17 May) going through the roof. The anticipated UK staycation is seeing the price of holiday lets and hotels soaring. This is real inflation that most people can see. It is very different from the asset price inflation that has benefited fewer people since the end of the financial crisis more than a decade ago.

The real worry for policy makers is that the expectation of sustained inflation becomes entrenched across the economy. The usual response is to raise interest rates, but the US and UK economies are debt-based consumer economies where the wealth effect through high and rising stock and property markets has been used as a way to grow. Governments need tax revenues to pay off the costs of Covid-19 and are unlikely to kill the golden goose. Many people expect inflation to be let off the leash but this is a dangerous game.

What does this mean for investors in shares?

At the moment, we have commodity price inflation due to too much money chasing too few goods. Once restrictions wane, the hope and expectation is that the production of commodities will increase and supply chains will free up and this will bring prices down.

If it doesn't and the money being thrown at economies still means that demand outstrips supply, then we will have a problem for shares in general.

This will come in two forms: The valuation attached to earnings and free cash flows; and the ability to grow revenues faster than costs.

Let's look at valuations first. Last week, I wrote about the valuations of the US and UK stock markets and showed the price earnings (PE) ratios and free cash flow yields on each based on historic and forecasted profits. I said that they looked alright as long as interest rates and inflation stayed low because there was still a real return on them.

If we take the S&P 500 index at its current level of 4,063 as a benchmark for equities in general, we can see that with the US CPI running at an annual rate of 2.6 per cent there was still a real projected free cash flow yield on the index based on current forecasts – 1.4 per cent in 2021 and 2 per cent in 2022.

S&P 500: Real free cash flow yields

$	2019	2020	2021F	2022F
EPS	162.9	138	184.4	206.7
FCFps	163.7	131.9	164.2	191.2
4063				
PE		29.4	22.0	19.7
FCF yield		3.2%	4.0%	4.7%
CPI			2.60%	2.60%
Real FCF Yield			1.4%	2.1%

Source: FactSet/Investors Chronicle

With inflation at 4.2 per cent, those real cash flow yields go negative.

S&P 500: Real free cash flow yields with US CPI of 4.2 per cent

$	2019	2020	2021F	2022F
EPS	162.9	138	184.4	206.7
FCFps	163.7	131.9	164.2	191.2
4063				
PE		29.4	22.0	19.7
FCF yield		3.2%	4.0%	4.7%
CPI			4.20%	4.20%
Real FCF Yield			-0.2%	0.5%

Source:FactSet/Investors Chronicle

In simple terms, investors in the US stock market are now longer increasing the buying power of their money.

It is possible that companies may be able to grow their earnings and free cash flows by raising prices. That said, unless their customers' incomes also increase there is a risk that they may buy less stuff and earnings go down. Workers may also ask for higher wages to cope with higher costs and this too could reduce earnings and free cash flows. It's difficult to see how the S&P 500 goes up in price with a backdrop such as this.

The other, and perhaps more likely possibility is that the valuation of shares adjusts to reinstate a real FCF yield on current cash flow projections. This is done by shares falling in price.

Implied value of S&P 500 maintaining real yields with 4.2 per cent CPI

$	2021F	2022F
FCFps	164.2	191.2
Real yield required	1.40%	2.10%
Add Inflation	4.20%	4.20%
Nominal FCF yield	5.60%	6.30%
Value at nominal FCF yield	2932.1	3034.9
Current Value	4063	4063
Implied Upside/Downside	-28%	-25%

Source:FactSet/Investors' Chronicle

If we take the previous real FCF yields and add 4.2 per cent CPI to it we get the nominal FCF yield that most people look at. Dividing current FCF per share forecasts by these higher yields gives an implied valuation for the S&P 500.

Granted, this is somewhat of an academic exercise, but it illustrates the risks facing investors right now and why increasing numbers are getting worried about it. It shows why taking low interest rates as a permanent feature is not all of the story. The central banks have manipulated interest rates but controlling inflation is harder to do.

This risk is nothing new. In my book *How to pick Quality Shares*, I discussed the impact of bond yields on valuation. For many years, investors in UK government bonds were compensated by having yields that were above inflation to the tune of around 2-3 per cent.

If that relationship had stayed in place then share prices would not be anywhere near the levels that we have seen in recent years, as their free cash flow yields would have been higher and PE ratios lower. The lack of alternative, real-yielding investments has pushed people into shares and pushed up their prices for years.

More articulate people than me have been highlighting the risk of rising interest rates and rising yields from money printing and inflation for years. They have been unfairly mocked as share prices continued to soar. This doesn't mean they were wrong.

It's now understandable why more people are nervous. Where do investors put their money is a question that has arguably never been more difficult.

Some see a new commodities boom that could see mining shares do well. I also hear the arguments for a continuation of the rotation trade away from expensive shares into cheaper ones. Companies with inflation linked revenue streams such as water and electricity networks may also benefit from a haven status.

I'm struggling to work this one out. In a podcast this week, Keith Ashworth Lord, manager of the Sanford Deland UK Buffettology fund, called the rotation trade "a dash for trash".

This is perhaps a little bit unkind, but I kind of know where he is coming from. The concerns on the quality of businesses listed on the UK stock market are well founded in my view, but that doesn't in turn mean that the stocks of quality growth stocks are a buy at any price which is a view that has been reinforced in recent years.

If the US stock market has a sell off then it's highly likely that the UK market will as well. Some form of correction is arguably long overdue and would not be a bad thing, in my view.

Despite the worrying developments on inflation, I do see grounds for optimism for UK shares. Looking at recent results and trading updates, it seems clear that many economies and end markets are recovering faster than people previously thought. This offers a source of earnings upgrades and possible share price momentum in a more favourable inflation environment.

We are all still very much in the dark when it comes to the long-term impacts of Covid-19 on our way of life. The vaccine roll-out offers a lot of hope, but new variants suggest caution is still needed. How governments will repair their finances without sucking purchasing power out of fragile economies is another matter.

See fantasy portfolios versus comparators below...

Fantasy Sipp vs comparators year to date

Portfolio % returns	1 month	Year to date	1 year	2 years	3 years
iShares S&P 500 - B UCITS ETF	-2.6	7.3	24.4	38.4	51.8
iShares MSCI World Acc	-2.4	5.5	25.0	32.3	38.2
Fundsmith Equity T Acc	-2.1	3.5	20.2	32.4	54.6
Mid Wynd International Inv Trust	-3.2	1.1	25.5	39.6	47.1
Phil Oakley Fantasy Sipp	**-2.0**	**-0.7**	**15.4**	**25.3**	**44.7**
LF Blue Whale Growth Fund	-5.4	-0.9	17.6	34.0	59.3
iShares NASDAQ 100 UCITS ETF	-7.1	-1.0	23.4	64.6	84.2
Martin Currie Global Portfolio Trust	-3.7	-2.3	22.4	34.7	52.0
Smithson Investment Trust	-3.4	-2.7	19.2	41.0	
Lindsell Train Investment Trust	-5.4	-5.9	20.7	-22.9	40.4
Scottish Mortgage Investment Trust	-7.9	-10.4	54.2	113.0	116.0

Source:SharePad

In terms of investment performance, we can see the damage being done to the Quality Growth approach and particularly those funds with a high exposure to expensive shares and technology shares.

UK Quality Shares vs comparators year to date

Portfolio % returns	1 month	Year to date	1 year	2 years	3 years
FTSE All-Share - Total Return	1.7	9.9	24.9	8.0	4.7
Vanguard FTSE 250 UCITS ETF	0.4	8.7	40.3	18.5	12.8
Vanguard FTSE 100 ETF	1.9	8.5	20.4	4.1	0.8
Castlefield CFP SDL UK Buffettology Fund	2.0	5.1	30.0	19.3	33.8
Baillie Gifford UK Growth Fund	-1.0	5.1	43.6	29.0	25.6
Finsbury Growth & Income Trust	-0.6	1.9	12.6	5.5	18.7
Phil Oakley UK Quality Shares	**-1.8**	**1.5**	**16.9**		

Source:SharePad

The UK market continues to see its relative outperformance from a reflation trade and benefits from its exposure to mining and cyclical recovery stocks. This may have some

way to run, I still continue to believe that many of these companies have long-term sustainable growth prospects.

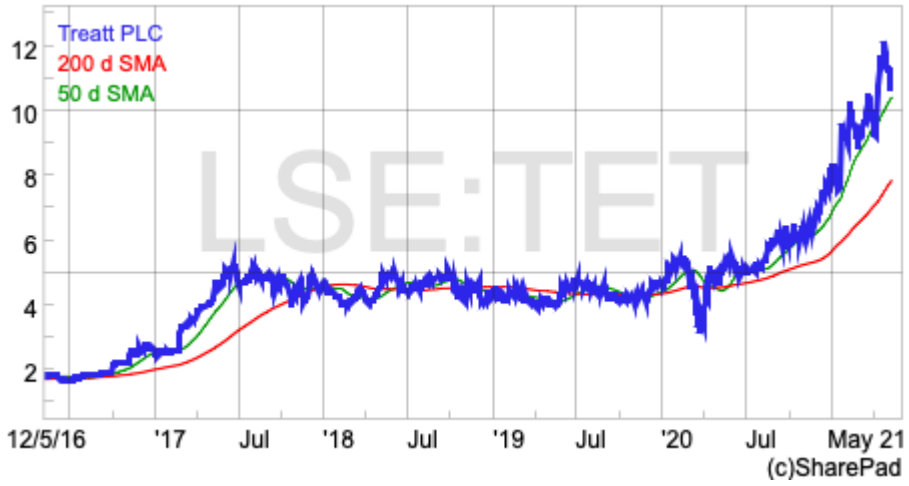
Therefore, the UK market remains one for diligent stock pickers despite the recent strength of the market in general.

Companies round-up

The six companies this week are:

- Treatt
- Redde Northgate
- Spirax-Sarco
- Morrisons
- Diageo
- Greggs

Treatt



Treatt's (TET) flavourings and fragrances business has come alive in the past 18 months. It has always been an interesting business with potential, but for a long time has been dominated by its large and volatile citrus business. A few years ago, I was also concerned that its profits were overstated by old assets and underinvestment.

Today the business is in very rude health with good future growth prospects. In short, there's a lot to like. Its products are niche and are backed by substantial intellectual property. The key attraction of them is that they enable customers to create differentiated products both in terms of flavouring and health. When it comes to the

global beverages markets, these are two key long-term themes which appear to still have legs.

This week's half-year results showed that the strong momentum in the business has continued. Revenues were up by 13.5 per cent with operating profits up by 73 per cent. The key driver of this was the price increases experienced by its citrus business, compared with a weak period last year. As a result, gross profit margins increased by 880 basis points to 35 per cent. Margins were also boosted by a continued shift in revenue mix to faster growing, higher margin tea, fruit and vegetable and health and wellness (such as sugar reduction) products.

Treatt: Sales mix and organic growth rates H1 2021

Product	Sales growth %	% of sales H121	% of sales H1 20
Citrus	0.4	44	50
Tea	93	11	6
Fruit & Veg	50.4	10	7
Health & W'ness	29.1	8	7
Synthetic Aroma	16.1	18	18
Herbs & Spices	-13.3	9	11

Source:Treatt

The outlook for the business remains very encouraging, with the outlook for full-year pre-tax profit being upgraded from £18m to at least £20m. Based on the current annual run rate of the business, it would not surprise me if the company did better than this, although the strength of sterling and commodity costs could prove to be a bit of headwind.

The return on capital employed continues to rise and is now 16.6 per cent, compared with 13.6 per cent at the end of last year. The capital employed figure also includes £33m of cost related to the new UK facility, which is not earning any money yet. Strip this out and the underlying return is 23 per cent, which is good, but highlights how old assets can flatter financial ratios.

That said, the outlook for this business seems good enough to make similar returns on this new investment. The current favourable trends look set to continue, while there remains largely untapped potential in segments such as cold brew coffee, which Treatt plans on producing its extracts for in the UK as it already does in the US.

Treatt: Past 12 months' financial performance

£m	LTM
Revenues	116.2
Gross profit	39.1
Operating profit	19.6
Pre-tax profit	19.1
Invested Capital	118.1
ROCE	16.6%
less New UK Site	-33
Op Inv Capital	85.1
Underlying ROCE	23.0%
Gross margin	33.6%
Op margin	16.9%

Source:Treatt/Investors' Chronicle

A look at the company's cash flow shows a significant working capital outflow in terms of trade receivables and stocks. This can sometimes be a cause for concern, but in this case is a sign of strength. The strong trading at the end of the half year explains the higher trade receivable balances, whereas a strong forward order book explains the stock build.

At 1,087p, the shares trade on a one-year forecast rolling PE of 39.4 times, which doesn't look a great entry point for me, but the shares are worth having on a watchlist.

Treatt forecasts

Year (£m)	2021	2022	2023
Turnover	123.5	130.8	139.9
Ebitda	23.5	26.9	29.6
Ebit	19.9	21.5	22.9
Pre-tax profit	19.9	21.6	23.5
Post-tax profit	15.7	17.2	18.7
EPS (p)	26.3	28.4	31.3
Dividend (p)	7.2	7.9	8.8
Capex	10.9	5.7	6
Free cash flow	-2.8	12.4	13.4
Net borrowing	6.1	-4.8	-13.5

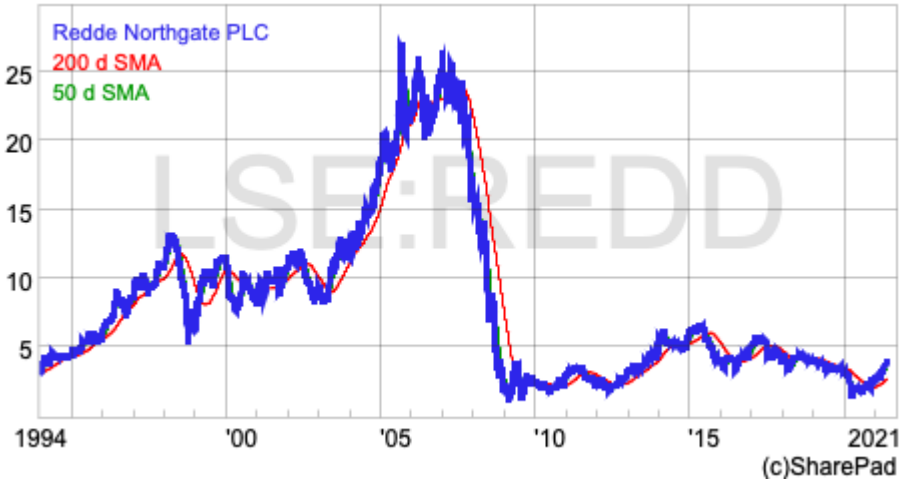
Source:SharePad

Redde Northgate

Back in my days as a City analyst I used to know **Redde Northgate (REDD)** quite well. On first impressions, I didn't like it too much as it needed to spend a lot of money to grow and van rental was hardly the most exciting business. I remember venturing up to Darlington on a cold winter's day back in 2003 to meet the company and came back feeling a bit more positive about it.

In those days, it was able to follow a very sensible and effective business model. It was able to grow the number of vans on hire and keep them on hire for nine days out of every 10. This was backed up by good levels of customer service and fleet management, especially the avoidance of losses on used vans.

It bought a Spanish business called Fualsa for an absolute steal and then took out its largest competitor called Record just before the financial crisis struck. The company was heavily exposed to the Spanish construction market which was hammered in the recession and the heavy toll almost killed the business off as its share price collapsed.



The company then struggled for a good while, but now seems to be getting back to being in a good place. Its merger with Redde last year has brought together a van rental and fleet management business that looks well placed to grow its profits in the years ahead. That said, van rental remains a very cyclical business so the inclusion of less cyclical fleet, incident and accident management seems to improve the quality of earnings here.

Current trading is decent. The UK van rental fleet increased by 4 per cent in the second half of the year ending in April with the Spanish fleet flat. The UK business has recovered strongly with 13 per cent fleet growth for the year with Spain more subdued with growth of 1.9 per cent.

The good news is that vehicle disposal profits are better than expected due to a very buoyant second hand light commercial vehicle market. Disposal profits are a key check of profit quality in a vehicle rental business as it is easy to boost rental profits by under depreciating assets. This will be highlighted when sales proceeds are less than the carrying value of assets on the balance sheet. There are no such concerns here.

Going forward, the Redde business should see a pick up in the new financial year, as it has been hurt by fewer accidents and incidents to manage as lockdown has reduced UK traffic levels.

The better performance on disposals means that full-year pre-tax profits for the year ending April 2021 should not be less than £92m. The previous range of analysts' forecasts was £83m-£88m. This is not a business that makes great returns on capital, but trading on just over 11 times one-year rolling forecast EPS looks reasonably priced to me.

Redde Northgate forecasts

Year (£m)	2021	2022	2023
Turnover	1,142.00	1,297.50	1,382.60
Ebitda	314	349.8	375.2
Ebit	98.1	118.5	135.3
Pre-tax profit	84.7	104.1	122.2
Post-tax profit	67.8	83.7	99.8
EPS (p)	27.4	33.8	39.2
Dividend (p)	13.8	17.1	19.7
Capex	235.1	296.8	252.3
Free cash flow	66.8	45.4	55.1
Net borrowing	595	617	614.7

Source:SharePad

Morrisons

Morrisons (MRW) continues to trade well and continues to look decent value to income investors with perhaps a possible bit of corporate spice (in the form of a takeover by Amazon) thrown in.

This is a company that has struggled to find a consistent value message with its customers since it bought Safeway back in 2004, but I think that has been sorted out now. It is no longer losing market share and has real momentum in its online and wholesaling business.

Its first-quarter trading statement confirms this. Like-for-like (LFL) sales excluding fuel were up by 2.7 per cent, which was a very decent performance given the tough comparatives from the lockdown sales boom from a year ago. Two-year LFL sales were up 8.7 per cent.

Online sales grew by 113 per cent. This is admittedly from a low base compared with its competitors, but it shows that its own business and Morrisons at Amazon are winning plenty of customers.

The Wholesale business has seen LFL sales growth of 21 per cent. This has primarily come from more Mccoll's stores being supplied, but it has signed and renewed contracts with other key customers, which include a growing number of petrol station operators.

What's encouraging is that despite rising commodity and freight costs, Morrisons has cut prices for its customers which means that sales volumes are growing faster than revenues. This shows that people are buying more stuff from it, which I see as a good sign of its improving competitive position.

Another bit of good news is that fuel sales have almost recovered to pre-pandemic levels. Last year the fall in fuel sales saw a big working capital cash outflow from the business which will reverse this year, boosting cash flow and allowing debt to come down further.

While sales will come up against tough comparatives for the rest of the year, Morrisons should be able to get a small profit boost from its in-store cafes opening again next week.

All looks well with this business and profit forecasts should be nudging up a bit. At 180p, the shares are not expensively valued on 12.6 times one year forecast rolling EPS whilst offering a 5 per cent dividend yield backed by robust free cash flow generation.

Morrisons forecasts

Year (£m)	2022	2023	2024
Turnover	17,992.9	18,302.5	18,608.8
Ebitda	1,116.3	1,144.6	1,177.0
Ebit	546.3	566.2	594.0
Pre-tax profit	441.7	468.8	499.9
Post-tax profit	342.6	356.7	377.5
EPS (p)	14.2	14.9	15.4
Dividend (p)	9.1	9.6	10.3
Capex	582.7	550.2	540.1
Free cash flow	559.3	406.6	421.5
Net borrowing	2,428.1	2,393.4	2,440.5

Source:SharePad

Diageo

You should never be so complacent to buy and forget about your investments, but **Diageo (DGE)** is a business which almost fits that bill for me. It has been through a bit of a rough time with the closure of bars, restaurants and the collapse in air travel, but it is now proving what a good business it is given the strength of its revenue and profit recovery.

Diageo is a great example of global brand strength, which its competitors struggle to match. It arguably has the best portfolio of premium spirits brands in the world, as well as global beer brands such as Guinness. If someone wanted to set up in competition with it in premium and single malt whiskies then the cost of financing 12 years or more of maturing casks, let alone the global distribution required would be billions of pounds.

The business is recovering well and is performing strongly in the all-important North American market. Organic profit growth for the year to June 2021 is now expected to be at least 14 per cent and just ahead of sales growth.

Momentum should continue to build going forward, especially when travel retail opens up again in a meaningful way. Cash generation continues to be strong and is now strong enough for the company to start buying back its own shares again.

That said, I'm not that enthused with buybacks when the shares trade at more than 26 times one-year rolling forecast EPS, which is a full valuation for an excellent and resilient business.

Diageo forecasts

Year (£m)	2021	2022	2023
Turnover	12,274.7	12,953.6	13,670.5
Ebitda	4,116.4	4,533.7	4,894.6
Ebit	3,671.3	4,069.3	4,393.2
Pre-tax profit	3,560.2	3,980.4	4,361.9
Post-tax profit	2,660.2	2,980.5	3,236.7
EPS (p)	113.5	127.1	139.1
Dividend (p)	70.2	73.6	76.9
Capex	650.4	683.9	705.3
Free cash flow	2,453.0	2,542.8	2,709.6
Net borrowing	13,201.3	12,984.2	12,944.8

Source:SharePad

Spirax-Sarco

I've heard it said many times over the years that good things happen to good companies and that is one of the many reasons you should own them. This does not always hold true but I think there's some justification for people saying it.

Spirax-Sarco (SPX) remains one of the UK businesses that I admire the most. The customer-focused culture has been embedded for decades, which has complemented the excellent problem solving and performance products it makes across its steam, pumps and thermal solutions businesses.

Its business is cyclical and tends to see its revenues move very closely with trends in global industrial production. However, the company's products are essentially part of its customers' day-to-day operating expenditure rather than capital expenditure and so are much more resilient than many capital goods companies. Its profit margins have held steady in the low-to-mid-20 something per cent for years, through booms and recessions.

This is another business that is reporting demand recovering much faster than it expected just a few weeks ago. First quarter global industrial production has increased at 7.4 per cent, compared with a previous expectation of 6 per cent and Spirax-Sarco's revenues have grown faster than this.

Watson Marlow continues to be the start performer. It is still benefiting from the demand for its Covid-19 vaccine products in its Pharmaceutical and Biotechnology division, where sales were expected to grow by around 35 per cent in 2021. That expectation is now 55 per cent.

In other divisions, including Steam, the Watson Marlow's traditional pumps business and in Thermal Solutions, revenues have grown ahead of the growth in industrial production.

Raw material and freight cost increases have been well contained and the operational gearing in the business has seen profit margins increase. This may not be the case for the rest of the year, as investment in the business has lagged sales growth and this may reverse going forward. That said, margins should still increase for the year as a whole.

The outlook for the business looks to be very bullish with global industrial production now expected to grow by 8.5 per cent in 2021. The guidance for the drop through from revenues to operating profit has increased from 30 per cent to 35 per cent.

Spirax-Sarco forecasts

Year (£m)	2021	2022	2023
Turnover	1,291.1	1,357.7	1,435.5
Ebitda	353.1	378.5	405.9
Ebit	300.0	321.4	344.1
Pre-tax profit	293.2	314.9	338.3
Post-tax profit	212.9	228.6	243.1
EPS (p)	288.9	310.4	330.7
Dividend (p)	125.4	134.1	144.8
Capex	71.5	61.6	62.4
Free cash flow	161.0	206.0	225.7
Net borrowing	172.8	88.0	-33.6

Source:SharePad

Spirax shares have looked expensive for some time now, but it is a business I would be loath to sell from either fantasy portfolio. At £118 and trading on a one-year forecast rolling PE of 39 times, it may be stretching things to say that they are reassuringly expensive but I'm hanging on to them.

Continued below...

Greggs

Greggs (GRG) is experiencing a similar strong recovery in its fortunes. Two-year LFL sales for the past eight weeks are down by 3.9 per cent, but have turned positive since non-essential retail outlets reopened on 12 April.

Not only does this company have great products which offer outstanding value to its customers, it continues to relocate its business to where its customers now are and away from where they used to be. It has opened 34 new shops this year and is locating them in retail parks, at the side of major roads and in petrol stations. There is still much potential to relocate shops away from high streets to these kinds of locations when leases expire.

The delivery business continues to be rolled out and is now in 800 shops.

In the past Greggs has suffered from rising ingredients costs that have eaten into its profits and the current commodity price inflation is a concern. At the moment, it says that everything is under control and in line with its expectations.

Sales are recovering strongly and much better than previously expected, so Greggs now thinks that it could match its 2019 revenues this year. There is still some uncertainty around this as they try to anticipate the scale of office returns and lunchtime trade, as well as the impact from the opening up of competitors' shops. Not so long ago, Greggs was being discussed in some circles as a business that had suffered permanent damage due to the likely changes in working and shopping patterns.

The question is how much of this strong recovery has already been factored into Greggs' share price which has now recovered its previous peak. It is a business that is understandably admired but a rating of 29.8 times one-year rolling forecast EPS probably reflects this.

Greggs forecasts

Year (£m)	2021	2022	2023
Turnover	1,094.8	1,227.4	1,306.2
Ebitda	224.2	238.7	265.2
Ebit	100.9	125.9	142.5
Pre-tax profit	96.6	120.2	135.4
Post-tax profit	87.9	97.3	109.5
EPS (p)	78.6	96.2	109.6
Dividend (p)	29.1	43.1	50.7
Capex	71.0	90.1	95.0
Free cash flow	115.9	105.3	124.7
Net borrowing	74.0	49.5	36.9

Source:SharePad

Investors' Chronicle | Alpha

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