STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

VOL 22 / ISSUE 42 / 22 OCTOBER 2020 / £4.49

SHARES

WE MAKE INVESTING EASIER

BEYOND BREXIT

The outlook for UK stocks and the pound

PLUS

RECKITT BENCKISER SHARES HAVING **BEST YEAR SINCE 2015**

THE UK STOCK MARKET HAS A **NEW GOLD GIANT IN TOWN**

INVESTORS FINALLY GET A STEER ON **NOVACYT'S EARNINGS POTENTIAL**

Expect a UK market rebound? Choose the FTSE 250 for stronger growth

The mid cap index has a good track record of outperforming the FTSE 100

It is crunch time once again for UK equities as investors try to make sense of how Brexit will play out. As we write, trade negotiations between the UK and EU have seen both sides engage in a game of bluff.

Reaching a deal could be a momentous occasion for UK stocks as it would remove a lot of the uncertainty that has hung over the market for the past four years since the Brexit referendum. In particular, it could be the trigger to attract foreign interest in the UK stock market which is looking very cheap compared to equities in many other parts of the world.

As we discuss in this week's feature on the Brexit trade talks, the FTSE 250 mid cap index could benefit from renewed interest in UK equities as about two fifths of its constituents' earnings are generated domestically and they should benefit if the pound strengthened on a trade agreement that avoids tariffs.

The FTSE 250 index is generally made up of faster growing companies than the FTSE 100 and this has resulted in superior gains for investors over the years.

The FTSE 100 has a mixture of high quality companies with slower growth and businesses seeing their markets disrupted or heading for obsolence, albeit you tend to get more generous dividends from this index.

The FTSE 250 has significantly outperformed the FTSE 100

	FTSE 100	FTSE 250
1 year change	-16.9%	-11.6%
5 year change	-6.5%	5.7%
10 year change	4.1%	65.2%
15 year change	14.9%	141.0%
20 year change	-4.5%	178.0%

Source: SharePad, as of 19 Oct 2020. Share price only, excludes dividends

The FTSE 250 has outperformed the FTSE 100 index over the last one, five and 10 years, as illustrated by the accompanying table. Over the past decade the FTSE 250 has achieved 8% annualised total returns versus 4.3% from the FTSE 100.

The beauty of the FTSE 250 is that it contains a broad range of sectors, from software and transport to engineering and leisure, as well as a large range of investment trusts covering different parts of the market.

It also contains a lot of companies utilising technology to make themselves stronger, such as comparison website **Moneysupermarket (MONY)** and industrial thread manufacturer **Coats (COA)**.

The combined earnings per share for companies in the FTSE 250 are forecast to grow by 13.3% over the coming year, says Stockopedia, compared with 11.8% for the FTSE 100. Both those estimates imply decent earnings recovery following this year's Covid-related disruptions.

While there is a strong argument to make in favour of buying the FTSE 250, it is impossible to say with certainty how the trade talks will play out. Last Christmas it seemed as if the UK was going to be a good place to invest after the general election provided political certainty. Unfortunately the widely-expected recovery in UK stocks was derailed by coronavirus.

Failure to secure a trade deal might cause another wobble in the UK stock market but there is an argument to say a lot of bad news is already priced in. Nervous investors might be better waiting on the side lines until we know the outcome. Those with an appetite for risk may take the view that the FTSE 250 is worth buying now in order to be in position for a UK market pop should it come.

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Reckitt Benckiser shares having best year since 2015

The Dettol and Lysol supplier continues to have a good crisis, though there are earnings headwinds ahead

Dettol, Lysol and Durex maker **Reckitt Benckiser (RB.)** is having its best year on the stock market in five years.

So far this year (to 20 Oct), its share price has risen by 17.4%. That is nearly twice as much as it achieved in 2016 (9.6%) and fast approaching the 20.6% achieved in 2015.

Helping to drive the share price has been yet another strong trading period with better-than-expected third quarter like-for-like sales growth driven by super-normal demand for its health and hygiene products during the pandemic.

Among a select band of companies to have continued paying its dividend during the crisis, Reckitt is investing heavily 'in the relentless pursuit of a cleaner and healthier world', although the business does face some headwinds going forward including temporarily declining birth rates which could impact its infant formula business.

Like-for-like sales grew by an impressive 13.3% in the third quarter amid bumper demand for global disinfection brands Dettol, Lysol, Sagrotan and Napisan. Chief executive Laxman Narasimhan now expects Reckitt to generate annual like-for-like growth in the 'low double digits' this year, upgraded from 'high single digit' growth previously.

Reckitt Benkiser has improved its supply chain and is saving significant sums through its productivity plan.

It has enjoyed exceptional demand for disinfectants in recent months, with existing and new customers clamouring for its trusted brands. Management expects 'structurally higher levels of demand to persist longer term as new consumer cleaning and sanitation habits become engrained'.

Away from the home, there is growing consumer demand for hygiene products in public and shared places such as public transport, hotels, schools and offices.

Reckitt is now directly selling Dettol and Lysol in 19 new countries and is taking Dettol's hand sanitiser and wipes into new international markets.

On the negative side of the ledger, social distancing may result in a weaker cold and flu season this year, impacting brands such as Mucinex.

Risk-averse investors should also note that restrictions on movement have impacted cross-border sales for infant formula between Hong Kong and China. Reckitt Benckiser also cited evidence that birth rates will be further lowered in coming quarters because of behaviour changes related to the pandemic, stirring up quite a headwind for its infant nutrition business in 2021.

Across the pond, one of Reckitt's peers, Procter & Gamble also raised its earnings guidance as its latest quarterly sales grew by 9% with the pandemic powering sales of Procter's cleaning and laundry products.

Reckitt Benckiser share price performance

Year	Gain/loss
2020*	17.4%
2019	1.9%
2018	-13.1%
2017	0.5%
2016	9.6%
2015	20.6%

Source: SharePad. *1 Jan to 20 Oct

Investors finally get a steer on Novacyt's earnings potential

Its global customer base and brand recognition are driving a step-change in revenue potential

Investors in diagnostics specialist group **Novacyt (NCYT:AIM)** have been treated to two important pieces of news.

Earnings estimates are available for the first time since the company listed on AIM in 2017 after Numis starting research coverage on the stock, which has gone up by 7,190% in value this year.

Numis analyst Stefan Hamill believes Novacyt could emerge as a 'long-term diagnostics winner' based on a credible three-pillar strategy of organic, research and development, and accretive acquisitive growth.

Given the uncertain nature of when and if an effective vaccine becomes available, Hamill has modelled four scenarios labelled bear, base, bullish and blue-sky and then weighted them with the base and bullish cases each receiving 40% and the bear and blue-sky cases each getting 10%. The calculation values the business at £13.65 per share versus a 930p price at the time of writing.

Shares previously highlighted the possibility of a revenue cliff from 2021 as demand for testing abates and it should be noted that all of Hamill's scenarios model for revenues and profits to fade by 2024.

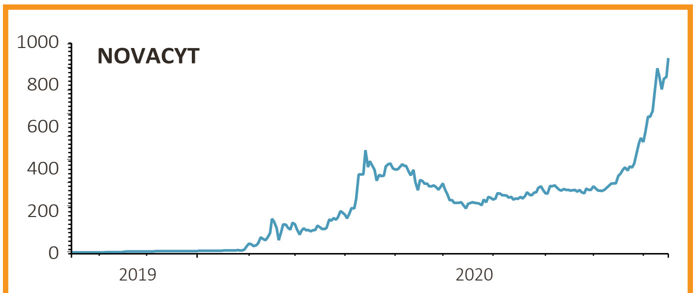
In the base case, revenues reach €390 million in 2021 driven by testing demand growing during the peak flu months in the first half, before falling back to €81 million in 2024. Hamill estimates the shares are worth 950p in this scenario.

Bull case revenues reach €600 million in 2021 on the basis that the second phase of the UK Department of Health and Social Care (DHSC) contract is triggered and the blue-sky case has revenues of over €1 billion reflecting the contract hitting its maximum potential and Novacyt becoming a strategic supplier into the NHS. The bull case has the shares valued at £15, while the blue-sky value is £34.

Meanwhile the bear case factors in no upside from the DHSC contract with revenues forecast to reach €210 million in 2021 before slipping back to €41 million in 2024. The shares are expected to be worth 450p under this scenario, says Hamill.

The second piece of positive news was Novacyt's acquisition of IT-IS International which is the exclusive manufacturer of its real-time polymerase chain reaction instrument range. The deal increases vertical integration and evolves the company into a broader diagnostic platform instrument and reagent manufacturer.

It gives the company end-to-end control of its near-patient testing system and increases the significant potential to win further contracts in decentralised settings such as the NHS and care homes.



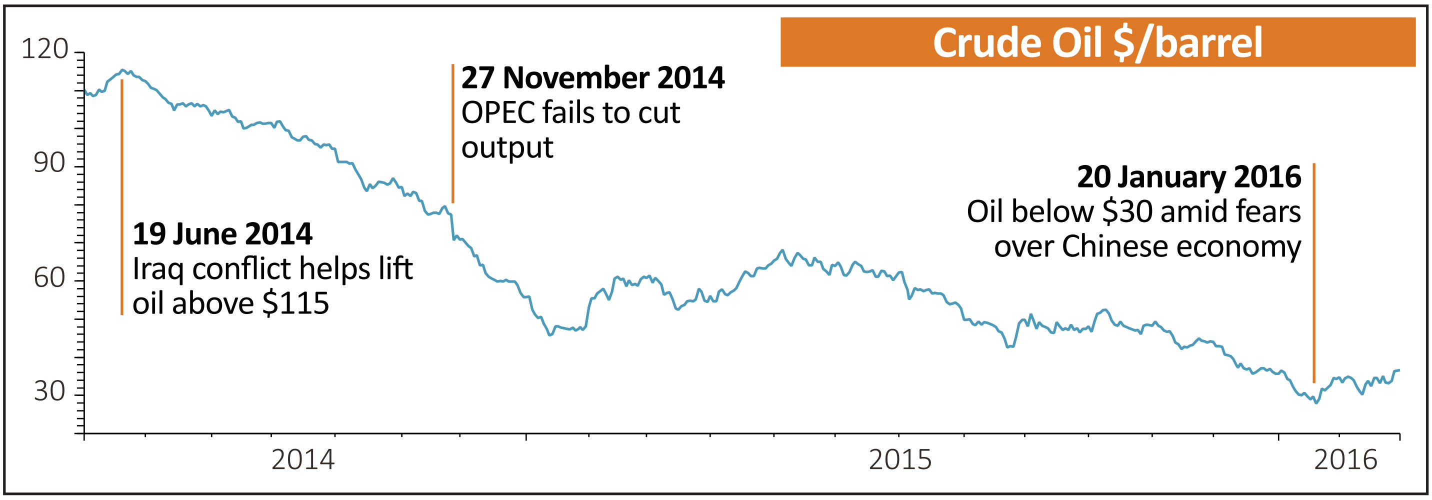
Novacyt base case projections

	2019a	2020e	2021e	2022e
Revenues (€m)	13.1	305	387	137
EBITDA (co.adj) (€m)	0.6	230	283	72
EPS (€ cents)	-7.4	292	326	80
Free cash flow (€m)	-1.4	105	223	140

Source: Numis, Novacyt. A = actual, e = estimate

Be prepared for a big movement in the oil price

If producers' cartel OPEC fails to delay a production hike then history suggests we could see a big fall in the commodity price



The price of oil has proved resilient in recent months with the global benchmark Brent Crude still above the $40 per barrel mark it has largely held since the summer. However, the market now faces a key test as producers' cartel OPEC and Russia announce their next big decision on production quotas.

Output cuts of 7.7 million barrels of oil per day are scheduled to be tapered to 5.8 million in January 2021. However, the market appears to be pricing in a delay to this move and will find out if this hypothesis is correct at a meeting in Vienna on 30 November.

If OPEC, dominated by Saudi Arabia, doesn't delay plans to increase production we could see a similar scenario play out to that seen in November 2014 where the oil price collapsed. It fell from well above $100 per barrel in June of that year to less than $30 by January 2016.

It seems unlikely the same mistake will be repeated six years on, however ensuring compliance may not be easy as producing countries face the unenviable choice of giving up on potential oil revenue or risk flooding the market and undermining prices.

In 2020 the issue is largely centred on demand rather than supply as the pandemic and its accompanying travel restrictions have led to a drastic reduction in the use of both petrol for cars and jet fuel for a grounded aviation sector.

Bank of America estimates that 2020 will see oil demand down 10 million barrels of oil per day on average led by transport fuels. It says: 'In aggregate, oil demand could take two to three years to reach pre-Covid levels, but this will be heavily dependent on when a vaccine is readily available.'

This has ongoing implications for oil majors **BP (BP.)** and **Royal Dutch Shell (RDSB)** and their ability to sustain dividend payments which have already been scaled back significantly earlier in 2020.

Investment bank Morgan Stanley says: 'At the moment, Big Oil's outlook is particularly cloudy. Perhaps, in the fullness of time, it may become clear that "now" is actually the moment to build positions (buying shares in the sector). However, further downside risks are also still surprisingly large, in our view.'

It added that in the medium-term the capital expenditure associated with a shift to renewables could put pressure on the sector's capacity for dividends, perhaps leading to more cuts.

Crisis brewing at JD Sports as orders delayed

The 'King of Trainers' says it is working hard to resolve online order problems ahead of the peak selling period

A problem is brewing at **JD Sports Fashion (JD.)** where customers have experienced order delays and poor customer service, according to comments on social media. Negative sentiment towards the brand could potentially hurt earnings, particularly if the situation isn't resolved soon.

'Due to increased social distancing measures and lockdown restrictions across large parts of the UK, we are currently experiencing high levels of demand from customers choosing to shop online,' a JD Sports spokesperson told *Shares*.

'At the same time, and in line with the latest Government guidelines, we have also had to reduce the number of colleagues working in our UK distribution centre to ensure they are able to work safely on site while practising social distancing. Unfortunately, this has resulted in some temporary delays in shipping online orders.'

The spokesperson insisted: 'We are working hard to reduce this backlog and are already in the process of bedding in new automation technology to increase our online fulfilment capacity ahead of Christmas and Black Friday.'

JD is benefiting from buoyant demand for athleisure as people continue to work from home during the pandemic. Yet on its Instagram and Twitter feeds, customers have complained that the web page and app have not been functioning properly and that orders have been cancelled without warning or not even shipped.

Warehouse problems previously caused a big share price sell-off at **ASOS (ASC:AIM)**.

RIP austerity as Eurozone budget deficits soar

Nothing is so permanent as a temporary government program said Milton Friedman

EUROZONE GOVERNMENTS have racked up close to €1 trillion of budget deficits on emergency measures to combat the economic pain caused by Covid-19. The *Financial Times* calculated the 19-country block's fiscal deficit will increase to an aggregate €976 billion, equivalent to almost 9% of GDP this year.

This represents a staggering 10-fold increase from 2019 levels and dwarfs the previous peak in 2010 when budget shortfalls hit 6.6% of GDP according to the European Central Bank (ECB).

Moreover, governments estimate deficits will remain high even if economies rebound in 2021, with the shortfall only shrinking to an estimated 6% of GDP.

There appears to have been a sea-change in thinking about the best way to deal with today's health crisis compared with the financial crisis of 2008 with Carmen Reinhart, chief economist at the World Bank, saying: 'First you worry about fighting the war, then you figure out how to pay for it.' A decade ago, she was advocating austerity to prevent public debt undermining economic performance.

Today's narrative is that with borrowing costs near zero, countries can service increased debts without posing any threats, so long as economies grow faster than interest costs.

Investors meanwhile seem sanguine about the risks with borrowing costs in Italy and Greece falling to record lows last week amid the ECB's bond buying policy.

The UK stock market has a new gold giant in town

Yamana Gold offers better value than its London-listed large cap peers

'A stable operator with plenty of upside' is how analysts have described **Yamana Gold (AUY)**, the Canadian mining giant which returned to the London stock market earlier this month.

The miner, which has been listed on the Toronto stock market since 1995 and New York since 2007, has gold and silver mines in Canada, Brazil, Argentina and Chile, with annual production of close to one million ounces of gold a year.

The price of gold looks set to remain at elevated levels well into 2021, underpinned by the continuing clouds of economic uncertainty which show no signs of disappearing, as well as the potential for rising inflation and central banks stepping up gold purchases once again.

YAMANA GOLD
BUY
(AUY) 460p
Market cap: **£4.5 billion**

That bodes well for Yamana's profit margins and its ability to shift from a debt-laden business to a cash-rich one.

DIVERSIFICATION BENEFITS

Key to Yamana's attractions is diversification – something very important for miners, as seen with the recent problems encountered by FTSE 250 miner **Centamin (CEY)** at its one and only mine – as well as its strong balance sheet and stable production, which allows it to capture the upside from high gold prices.

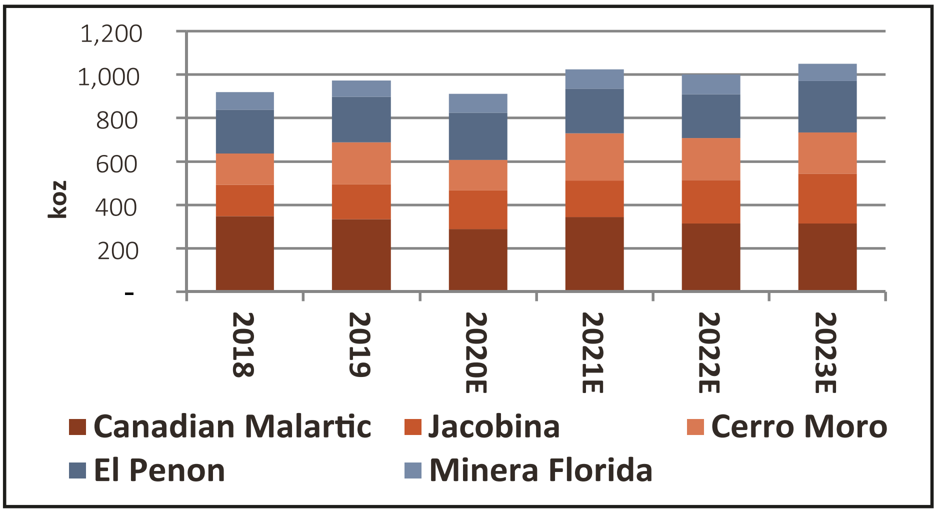
Valued at £4.5 billion, Yamana trades on London's Main Market but won't be eligible for the FTSE indices due to its type of listing.

The Canadian miner originally joined AIM in 2003 and moved to London's Main Market in 2007. It delisted in 2013 as most of its shares at that time traded on the Canadian and US markets.

It has returned to London to take advantage of a gap in the stock market for a larger sized gold miner. There are only two other gold miners worth more than £4 billion on the UK market, namely **Polymetal International (POLY)** and **Fresnillo (FRES)**.

Yamana's shares trade on a reasonable 1.3 times price to

Stable production from a diverse portfolio



Source: Berenberg estimates

book, making it significantly cheaper than the other big gold miners on the market. Polymetal trades on 6.5-times and Fresnillo trades on 4.1-times.

PAYING DOWN DEBT

Reassuringly for investors, Yamana has placed a big focus in the last few years on reducing its borrowings, with net debt forecast to fall from $1.65 billion in 2018 to $504 million by the end of 2020, bringing its net debt to EBITDA ratio down from 2.7-times to below 1-times. The company is expected to move to a net cash position by 2022.

Yamana should be in a good position to capitalise on the high gold price this year, with production in 2020 expected by analysts to be in line with its upwardly revised guidance of 915,000 ounces of gold, up from 890,000 ounces previously, produced at an all-in sustaining cost within its guidance range of $1,020 to $1,060 per ounce.

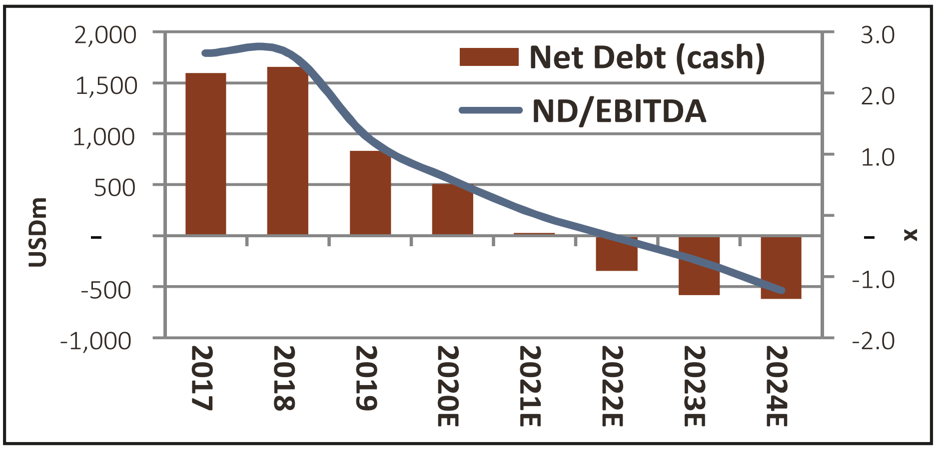
PROJECT CATALYSTS

Aside from the gold price, the miner also has other catalysts for share price growth.

Analysts at broker Berenberg see these catalysts as being the development of an underground mine at its Canadian Malartic site, the expansion of the plant at its Jacobina mine in Brazil, the feasibility study for its Agua Rica project in Argentina and extensions to the lives of its current mines through exploration, all of which could significantly increase its production capability.

Agua Rica, a major copper deposit, could well be the most exciting of these projects. Given the amount of copper at the site, if fully developed Berenberg thinks it could transform Yamana into a mid-sized copper producer as well as being a significant gold and silver producer.

Net debt moved below 1x EBITDA in Q3 and should be net cash by 2022...



Source: Berenberg estimates

Agua Rica is estimated to be a potential 150,000 to 200,000 tonnes a year copper and 100,000 ounces a year gold mine. If developed, the mine would use the existing infrastructure of the nearby Alumbrera mine (owned by Yamana, **Glencore (GLEN)** and Newmont) and therefore lower the amount of money needed to get it going.

Berenberg believes Agua Rica could add meaningful long-term free cash flow of around $200 million a year for Yamana over the life of mine, with significant skew to early years.

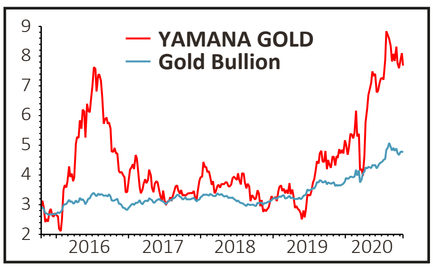
FREE CASH FORECASTS

In 2019, Yamana generated free cash flow to equity of $190 million. This is forecast by Berenberg to increase to $436 million in 2020 and $672 million in 2021.

Free cash flow to equity is a measure of how much cash is available to the equity shareholders of a company after expenses, reinvestment and debt are paid.

In 2019 Yamana reported revenue of $1.6 billion and earnings before interest, tax, depreciation and amortisation (EBITDA) of $673 million.

Weakness in the price of silver or gold would have a negative impact on Yamana's earnings and cash flow, while there is always risk with miners over the pace at which they deliver on their project development and exploration plans. However, Yamana is a well-established business which looks to be in good position to capitalise on the higher gold price, has plenty of avenues for growth and provides much better value than other larger-sized gold miners on the market.



This trust offers big potential if you believe value investing will thrive

The brains behind Aurora Investment Trust have a superb track record

There are three good reasons to get excited about the £125 million **Aurora Investment Trust (ARR)**. First, the shares that the trust owns are collectively undervalued according to the manager, Phoenix Asset Management.

It estimated that the portfolio had approximately 138% upside to intrinsic value at 22 September 2020.

While Phoenix was only appointed to manage the trust in 2016, its flagship Phoenix UK Fund follows an identical strategy and has outperformed the FTSE All-Share index on a net asset value basis (NAV) by 3.3% a year since launch in 1988, growing at an annualised rate of 7.5% a year.

Historically there have been 28 quarter-ends when the upside to intrinsic value was over 140%, resulting in the Phoenix UK Fund delivering an average net return of 60.8% over subsequent three-year periods or 17.2% annualised, demonstrating a positive relationship between extreme discounts to NAV and future fund performance.

The second reason to look at Aurora is the fact it doesn't charge a base management fee. Instead there is a performance

AURORA INVESTMENT TRUST BUY
(ARR) 169p
Net asset value: 167.3p

fee which is paid entirely in shares and importantly has a clawback mechanism calculated after three years.

The fee is calculated as one third of the annual outperformance of the FTSE All-Share Total Return index, capped at 4% of NAV. As a result of the strong alignment of interests, the ongoing charge is very competitive and last year was 0.45%, one of the lowest in the peer group according to Liberum.

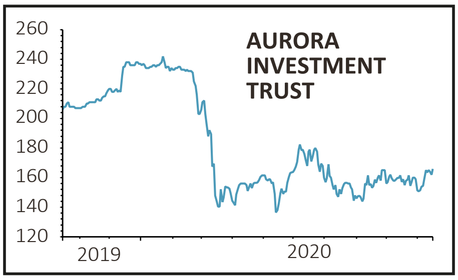
Thirdly, the UK market looks significantly undervalued relative to global markets, especially the US where the S&P 500 has recovered to pre-Covid-19 levels while the FTSE All-Share languishes 20% below January 2020 highs. Liberum estimates that UK equities trade on a forward price to earnings ratio of 14.8 compared with 22 for the US and 17.4 for Europe.

Aurora's portfolio is highly concentrated and consists of 16 companies with the top five holdings accounting for around

half of NAV. The fund is exposed to cyclical sectors most impacted by the pandemic with 28% in retail, 19% in housebuilders and 16% in budget airlines. The biggest holdings are Sports Direct owner **Frasers (FRAS)**, **Barratt Developments (BDEV)** and **EasyJet (EZJ)**.

The manager tries to find great companies with an enduring high rate of return on capital and a control over their own profitability. It looks to invest at attractive prices and specialises in 'determining whether the factors causing the price to fall are temporary or more permanent'.

Investing in this trust requires patience and an understanding that value investing as a style has been out of favour for some time.



TOUCHSTONE EXPLORATION

(TXP:AIM) 101.4p

Gain to date: 95%

Original entry point:

Buy at 52p, 25 June 2020

OUR FAITH in small cap oil play **Touchstone Exploration (TXP:AIM)** continues to be rewarded in stunning fashion as the company announces the latest in a series of positive updates.

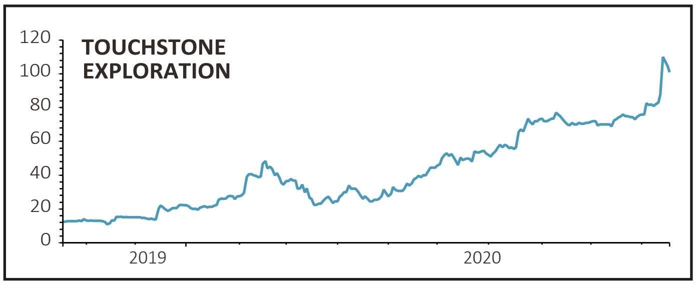
Touchstone has made another gas discovery on its Ortoire block onshore Trinidad, its third in succession, with the results of the Chinook-1 well exceeding pre-drill expectations.

FinnCap analyst Jonathan Wright comments: 'This not only de-risks the upcoming Cascadura Deep and Royston prospects but also opens up significant follow-on exploration opportunities.

'Touchstone has already identified 21 additional prospects on the Ortoire block representing five years of drilling inventory, for which we currently give zero value…this story has legs!'

He adds that the company should find it straightforward to commercialise the gas as the state operator (National Gas Company of Trinidad and Tobago) is a willing buyer of all the gas it can find.

The resulting increase in production as natural gas assets are brought on stream should result in a 'wall of cash' according to Wright which can be used to fund the development of Touchstone's assets, advance further exploration opportunities and potentially even pay a dividend.



SHARES SAYS: ↗

The shares have nearly doubled on our entry point but there looks to be further upside potential. Hang onto the stock.

KAINOS

(KNOS) £13.10

WINNING STOCKS FOR 2020

Gain to date: 82.4%

Original entry point:

Buy at 718p, 19 December 2019

DIGITAL TRANSITION specialist **Kainos (KNOS)** continues to perform very strongly as it reveals further growth linked to the need for businesses and organisations to up their digital game amid Covid-19.

A trading update on 14 October revealed customer demand remained high and had resulted in a very strong trading performance from 1 April to date, driven by the structural shift of digital adoption.

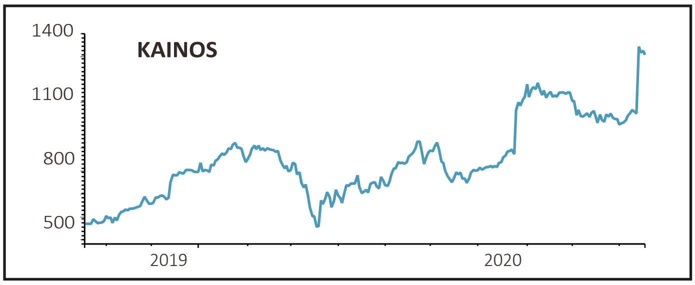
It now expects results for the full year to March 2021 to be materially ahead of consensus for revenue and significantly ahead for profit – albeit this reflects some non-recurring efficiencies.

The company said its digital services customers continued to prioritise digital transformation programmes in the NHS and public sector.

Its workday practice continued to benefit from its international scale and an ability to secure new consulting contracts across all its geographies, Kainos added.

Shore Capital upgraded its revenue and adjusted pre-tax profit estimates by 8% and 45% respectively for the financial year ending 31 March 2021. 'As a result, we are looking for 16% revenue growth to £207m and 88% adjusted pre-tax profit growth to £48 million in FY21.'

Results for the six months ending 30 September 2020 will be announced on 16 November.



SHARES SAYS: ↗

The company continues to deliver, keep buying ahead of first-half numbers.

LUCECO (LUCE) 245p

Gain to date: 111.2%

Original entry point:

Buy at 116p, 19 December 2019

THE RECOVERY AT LED lighting and portable power products firm **Luceco (LUCE)** continues to gather pace.

Not for the first time in 2020 Luceco is upping its earnings guidance amid an increase in demand. It now expects full year 2020 adjusted operating profit of between £28 million and £30 million compared with previous expectations for £23 million.

For the quarter ended 30 September 2020, revenue rose 7.5%, better than the low-single digit growth previously forecast, thanks to better than expected demand from online, multi-channel customers and DIY markets.

Third-quarter gross margin was better than expected, with higher sales volumes driving more efficient utilisation of manufacturing overheads, the company noted.

According to Numis analyst Kevin Fogarty the company is benefitting from a 'structural margin shift, improved business model and near-term earnings growth'. Based on his forecasts the shares trade on a 2020 price-to-earnings ratio of 17.3.

SHARES SAYS:

Sales momentum continues with positive implications for earnings growth. While the stock has more than doubled since we said to buy last December, it's worth running this winner and keeping the shares rather than cashing out now.

FORD MOTOR CO $7.59

Gain to date: 8.6%

Original entry point:
Buy at $6.99, 13 August 2020

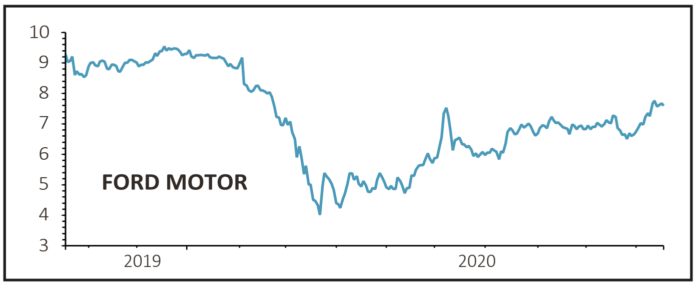
SHARES IN US-listed Ford Motor are nearly back at levels seen before the global market sell-off began in February. Helping to drive the stock in recent sessions was a bullish research note from investment bank Benchmark where analyst Michael Ward upgraded his rating to buy from hold.

The company will report its third quarter earnings on 28 October on a group basis. We already have a good idea about the state of trading as figures have been released for key geographic divisions.

The US arm saw Ford pickup truck sales enjoy their best third quarter in 15 years. Across the division, its retail unit sales were down 2% which is quite resilient given the ongoing pressures on consumer and business spending.

For the European arm, Ford achieved a record share in SUV sales for the third quarter. It said commercial vehicle sales had benefitted from growing societal trends like home deliveries and online shopping. The new Puma model has exceeded sales expectations.

In China, Ford posted its largest year-on-year sales increase since 2016 with third quarter sales up by 25.4%.



SHARES SAYS:
We originally said to buy as a recovery trade and confidence that new management would put the car giant back on track. The results so far are excellent so keep buying the shares.

Sirius Real Estate generates big returns from German business parks

Offering a 4% yield, the company has proved resilient to the impact of coronavirus

Who knew German business parks could be so exciting from an investor perspective? FTSE 250 constituent **Sirius Real Estate (SRE)** has generated a 12.3% annualised total return over the past 10 years from this apparently mundane asset class.

In this article we look at how the company achieves these returns, why the portfolio should be resilient in a post-Covid world and why this makes a sound investment for the long-term.

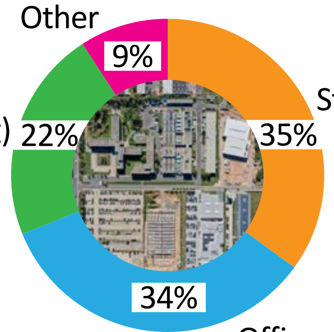
GERMAN-ONLY FOCUS

Sirius chief executive Andrew Coombs tells *Shares* the focus on Germany is no accident.

'The country is resilient. It would be easy to undersell the benefits of the German economy, health system, sense of society and social conscience,' he says.

Sirius owns and manages 65 sites across Germany – mostly close to its seven largest cities: Berlin, Munich, Frankfurt, Stuttgart, Cologne, Dusseldorf and Hamburg. Its parks were worth a combined €1.19 billion as at 31 March 2020. They are let for a mixture of uses including offices, storage and manufacturing and encompass more than 5,000 individual tenants.

Portfolio split



Source: Sirius Real Estate, data as at 31 March 2020

The assets fall into one of two categories: modern light industrial sites typically built since German reunification in the early 1990s and 1930s and heavy industrial assets. Interestingly many of these assets have been occupied by the same businesses for decades.

Coombs says this creates stickiness with tenancies. Feedback from some tenants suggests they would need years to execute a move to another site without disturbing their production lines or research and development processes. 'One of our tenants (engineering firm) Borsig has occupied its site since 1888,' Coombs says.

UNDERSTANDING THE MODEL

How does Sirius make money? Coombs explains: 'Our business model is all about identifying a 25 to 30-year-old business park and buying it for 25% of its replacement cost. The business park is either empty or has a couple of tenants and we invest to turn it into a community of 100-plus tenants. In doing so we take big spaces and subdivide them into higher quality smaller spaces.

'In effect we are charging a premium for reduction in size. The whole business park we get at a discount and once we split it into 100 parts, the price we sell it at to the tenant is much greater.'

Sirius takes a hands-on approach to managing these assets, having a point of contact on-site and taking care of items like utilities. That makes it more attractive to tenants and enabling Sirius to charge higher service fees.

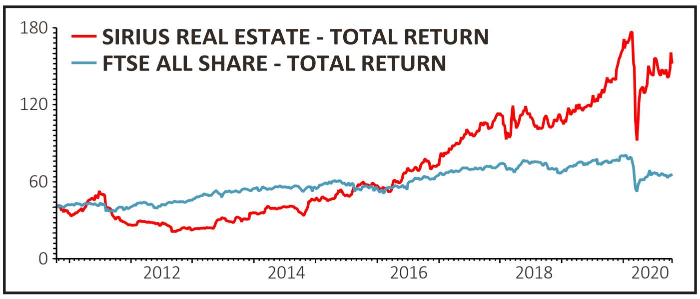
Thirty percent of the total shareholder returns generated by Sirius comes from dividends, with a policy of paying out 65% of funds from operations (operating cash flow) to shareholders. The other 70% comes from growth in net asset value.

ORGANIC GROWTH IN INCOME

Sirius' returns could be quite robust in a more uncertain economic environment because they have relatively limited reliance on yield compression – or in other words the value of the assets themselves increasing. Instead returns are driven by the organic increases in rental income it achieves through its investment in the sites.

For this reason, Coombs believes the portfolio could generate annual total shareholder returns of 10% even without any yield compression – leaving it well-positioned for a downturn.

> *"Our business model is all about identifying a 25 to 30-year-old business park and buying it for 25% of its replacement cost"*
>
> **Andrew Coombs, Sirus chief executive**



Sirius' four steps to enhancing value

SIRIUS ENHANCES rental and capital value through active portfolio management, which can be split into four key stages:

1 **Acquire**
It seeks out underutilised, multi-tenanted, mixed-use properties it can transform into higher yielding workspaces.

2 **Transform**
It converts properties into improved, more efficient, higher yielding, flexible workspaces. Additionally, its active ongoing programme reconfigures and upgrades existing spaces.

3 **Manage**
It seeks to maximise the value of its assets with an active and ongoing asset management programme with most functions performed internally.

4 **Recycle**
It sells off mature and non-core assets and uses the proceeds to purchase core assets with higher value-add opportunity.

Source: Sirius Real Estate

Sirius also sells on mature and non-core assets, recycling the funds back into the acquisition of sites where it can add more value.

RANGE OF TENANTS

Sirius rents to three different types of tenant. Big anchor tenants account for 40% of the revenue and include businesses like GKN, TDK and Amazon.

Micro SMEs (small to medium size enterprises) which are often one or two-man start-up operations contribute 10% and a big middle chunk of SMEs, some 2,500 tenants which fall into the category known as German Mittelstand, make up the other 50%.

In the six months to 30 September the company achieved a cash collection rate of 97.2% despite the pandemic and in line with normal levels. Coombs says plenty of hard work went into achieving that number.

While the big tenants have the knowledge and experience to deal with a crisis and deep enough pockets to keep paying the rent comfortably, and the much smaller businesses have sufficiently modest rental bills they can manage to find the funds in the short-term to muddle through, the middle portion have found life more challenging.

In response Sirius pushed staff resources towards customer liaison, talking to these tenants about the problems they were facing, helping direct them towards sources of state support and supporting the sharing of knowledge across its tenant base.

'SAFE AND DIVERSE'

On a sector basis, Sirius is well diversified. The largest industry by footprint, the admittedly challenged aerospace segment, represents just 3% of the portfolio. As Coombs explains: 'We built this portfolio to be safe and secure and ultimately diverse.'

With the market stabilising the company has scope for growth through acquisitions, both by employing the €113 million of unrestricted cash

Big anchor businesses like GKN, TDK and Amazon account for 40% of its revenue

as its disposal and by leaning on its joint venture with asset manager AXA agreed in 2019. It has already sold €70 million worth of assets to AXA and continues to manage them on its behalf.

There is plenty of headroom for growth. Sirius currently has net lettable space of 1.7 million square metres and the market of available assets in Germany is upwards of 300 million square metres.

In terms of competition for these assets Coombs says it would, even with his knowledge and experience, take at least five years to get to the point where someone else could replicate the Sirius model and that's assuming they could get the right people. 'The concept is quite simple, replication and execution are quite challenging,' he concludes.

In valuation terms Sirius is not overly expensive given the consistency of its returns and its well-rehearsed and resilient business model.

Based on Panmure Gordon's forecasts for the March 2021 financial year it trades on a yield of 4% and at a 7.8% premium to net asset value. That premium falls to 2.3% in 2022 based on forecasts for valuations to recover. Buy the shares.

A strong balance sheet

As at 30 September Sirius holds 12 of its business park assets without any debt, has a net loan to value of approximately 33%, a weighted average cost of debt of 1.5% and interest cover of more than 10 times at net operating income level.

By **Tom Sieber** Deputy Editor

BMO UK High Income Trust PLC invests in a quality, unique, concentrated portfolio aimed at meeting the needs of investors.

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BEYOND BREXIT

The outlook for UK stocks and the pound


By **Ian Conway**
Senior Reporter

While the coronavirus pandemic has been the dominant story of 2020 for global markets, ever-present in the background for UK investors has been the long and torturous road to Brexit, which is rapidly coming to a head with the UK needing to strike a trade deal with the European Union (EU) before 1 January 2021.

Despite having had more than four years to prepare for a deal, both sides have taken it down to the wire and both still claim the other needs to give ground.

Before we examine the chances of a deal, the implications of no deal and the potential impact of both scenarios on the UK market and the pound, it's worth recapping the events which brought us to this point and the issues at stake.

A POTTED HISTORY

In a referendum held in June 2016, the majority of those who voted chose to leave the EU, after which began what was meant to be a two-year countdown to the UK leaving the EU.

However, instead of leaving the EU at the end of March 2019, the UK asked for two extensions to Article 50, first until 30 June 2019 and then until 31 October 2019.

A fortnight before the new deadline new prime minister Boris Johnson's Brexit deal was lost on amendment in the House of Commons and the UK sought yet another extension to Article 50, with the EU agreeing a date of 31 January 2020.

On 23 January 2020, the EU (Withdrawal Agreement) Act received Royal Assent, forming the basis of the legislation for implementing the

Potential impact scenarios

Thin Trade Deal	**Reduce size of the UK economy by 2.1% in 2021**
No Deal	**Knock a further 0.5% to 1% off UK GDP (in addition to scenario above)**

Source: Institute for Fiscal Studies, 13 Oct 2020

Withdrawal Agreement negotiated by the UK and the EU. On 31 January 2020 the UK officially left the EU and entered a transition period due to run until the end of this year.

So far so good, until in September this year the UK tabled the Internal Market Bill, giving ministers the power to unilaterally make secondary legislation overriding elements of the Withdrawal Agreement including the Northern Ireland Protocol, which became law on 1 February, thereby breaching its legal obligations with the EU.

BREAKING THE LAW

After four years of trying to reach a Brexit deal, the response from Brussels was understandably terse. 'This bill is, by its very nature, a breach of the obligation of good faith, laid down in the Withdrawal Agreement. Moreover, if adopted as is, it will be in full contradiction to the protocol on Ireland and Northern Ireland,' said EU Commission president Ursula von der Leyen.

The UK admitted the Internal Market bill was intended to allow it to override elements of the Withdrawal Agreement, despite there being no such provision in the agreement, claiming in its defence the bill would breach international law only in a 'very specific and limited way'.

Since then, a game of bluff has developed with the EU launching legal action against the UK for contravening the Withdrawal Agreement and the UK saying it is prepared to abandon trade negotiations and leave on 'Australia-style' terms if needs be.

It should be said that while the EU and Australia have been negotiating since July 2018, there is currently no full free trade deal between them and most commerce is done under World Trade Organisation (WTO) rules so an 'Australia-style' deal is simply code for no deal.

IMPACT OF NO DEAL

No deal wouldn't just impact the trade in goods, it would mean cutting all formal bilateral ties with the EU including areas such as judicial, scientific and energy cooperation. Ironically, the only bilateral agreement left between the UK and the EU would be the Withdrawal Agreement.

Just days before the prime minister's self-imposed deadline of 15 October (the date of a summit for EU leaders) to reach a deal, Johnson repeated his threat to walk away if there was 'no clear progress'. Meanwhile the EU has said progress on key issues was 'still not sufficient' for talks to enter the intensive final stage of negotiations.

If a deal can't be agreed, millions of UK consumers and businesses face higher costs due to trade disruption and the reintroduction of tariffs. Also, as in 2016, the pound would probably slide which will further increase the cost of imported goods and contribute to a rise in inflation at the same time as the economy shrinks.

The only positive sign, if it can be called that, is that the two sides are using similar language, with cabinet minister Michael Gove telling a House of Lords committee that while the UK was keen to do a deal, 'we will not do a deal at any price', echoing comments from European Council president Charles Michel that 'Europe prefers a deal, but not at any cost'.

Factors that could encourage a re-rating of UK equities: the view from investment bank Stifel

1 **Trade deal with the EU:** The reaching of a deal would provide clarity for business and could be helpful for the UK stock market.

2 **Vaccine discovery:** The development of a viable vaccine could give the UK stock market a boost given that it would hopefully provide a route out of the current stop-go business closure cycle.

The UK is particularly sensitive to sectors including tourism and hospitality which are being badly hit with international travel and other restrictions, so any mean of easing these would be helpful for the economy.

3 **Dividend recovery:** The UK market has traditionally had some significant support from yield-seeking investors. An improvement to the corporate background and lifting of dividend suspensions could therefore be helpful for the UK stock market.

WHAT HAPPENS IF THERE IS NO DEAL?

- UK consumers and businesses face higher costs
- The pound could weaken in value
- Inflation could rise

DICTUM MEUM PACTUM

The Latin phrase 'dictum meum pactum' meaning 'my word is my bond' isn't just an old stock market adage, it's emblazoned on the coat of arms of the London Stock Exchange itself, symbolising the importance of trust in commerce.

By showing its willingness to breach international law, the UK – regarded globally as a strong proponent of the rule of law and the legal order – has raised serious questions about whether it has become an unreliable partner in international negotiations.

Trade negotiations are two-fold – they not only establish the rules governing future commercial relationships between the UK and the 27 EU member states, they also include rules on oversight.

Even if a trade deal can be negotiated, the EU now has reason to doubt that the UK will stick to the rules after implementation if it thinks it can somehow break them in a 'specific and limited way'.

STATE AID POLICY

A key area where the UK has yet to compromise is the so-called 'level playing field' for businesses including setting out its policy on state aid.

Ironically, the UK has always opposed state aid in Europe, yet it now wants to be able to set its own conditions for financial assistance. The EU wants to lock in joint rules to prevent the Government giving UK firms an unfair advantage over their European rivals by moving the goalposts once a deal is agreed.

The view of the US is also crucial, with both Republicans and Democrats criticising the UK for going back on its word, particularly over rules regarding the Northern Ireland Protocol.

Moreover, House speaker Nancy Pelosi has questioned whether UK food and drug standards will meet those of the US and whether the UK Government would seek to manufacture and export a Covid vaccine which, no longer being EU-approved, may not comply with the FDA's standards.

THE IRISH QUESTION

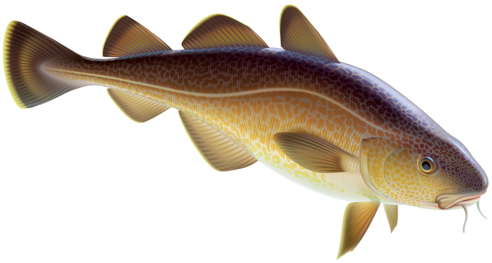
The position of Northern Ireland in trade talks has been a thorny issue since day one. The Protocol agreed by the UK and the EU as part of the Withdrawal Agreement was meant to avoid the need for any form of checks on goods along the 310-mile physical border between Northern Ireland and the Republic of Ireland, thereby safeguarding the Good Friday Agreement.

However, it still requires Northern Ireland to continue to enforce the EU's product standards and customs rules. This means safety checks and customs duties will have to be applied to goods brought into Northern Ireland from elsewhere in the UK from 1 January next year which are 'at risk of subsequently being moved into the EU', meaning there needs to be a regulatory and customs border in the Irish Sea, despite UK Government assertions to the contrary.

Even if the UK and the EU can negotiate a deal which eliminates tariffs on each other's goods and keeps checks to a minimum, the Northern Ireland Protocol is still necessary because EU law requires some product-standard checks.

The UK now claims the EU is trying to prevent the movement of goods between Great Britain and Northern Ireland and says it needs a 'safety net' to prevent the EU establishing an internal border between them, despite the Protocol ensuring 'unfettered access' for goods moving to and from different parts of the UK internal market without border checks.

For Europe, the issue of honouring checks and tariffs as per the agreement is fundamental, while for the UK it is political as it could be fined by the EU or called before the European Court of Justice, whose legitimacy it contests, should the EU decide it is not applying the rules correctly.



THE PRICE OF FISH

Alongside the Northern Ireland issue and state aid, another stumbling block to a trade deal is fish. Despite the relative lack of size and importance of the fishing industry to the UK economy, fishing rights have become one of the sticking points to a wider trade deal.

The issue comes down to whether the EU will give up a sufficient proportion of its quota share to allow the UK to grant a level of access for foreign boats to UK waters and to sign a deal.

'Conventional wisdom would suggest a split the difference approach could resolve the matter, but that would be to miss the essential point,' says Barrie Deas, chief executive of the National Federation of Fishermen's Organisations. 'The two sides are approaching it from different angles.

'For the EU this about quantum – how much access their vessels will have to fish in UK waters and how much of their advantage on quota shares can be retained,' add Deas.

When fishing rights were included in the conditions for the UK joining the 'common market' as it was known in the 1970s, the industry was considered 'expendable' and the UK agreed quotas based on the number of boats. The Dutch and French promptly expanded their fleets as quickly as possible to ensure as big a quota as possible.

While for the UK a deal is partly about quantum, it's also about principle and the UK's ability to act as an independent coastal state after the end of the transition period.

Unlike other aspects of the UK's exit from the EU, which may not become apparent for years, whether the Brexit deal is a good one or not will become apparent very quickly from 1 January. 'Fishing has a political immediacy,' says Deas.

Annual EU revenues from fishing in UK waters are around €650 million, compared with €150 million for UK fishing in UK waters, and observers believe some in Brussels, including the EU's chief negotiator Michel Barnier, German chancellor Angela Merkel and Dutch prime minister Mark Rutte, are ready to put pressure on France to compromise having enjoyed such an advantage for over 40 years.

A 'Norway-style' deal, which sees quotas agreed annually with minor tweaks based on scientific advice and sustainability concerns, is the most hoped-for outcome among UK fishermen and ultimately the most likely model if a deal is going to be struck.

'It would be crazy for the outside world if the UK and the EU will not be able to come to an agreement. I think it's in both our interest economically and geopolitically to get to a deal,' says Rutte.

CITY OF LONDON TO LOSE OUT?

Even with a negotiated deal on the trade of goods between the UK and Europe, trade in services – including financial services – is excluded.

For the City of London this could be a major headache as more than half of the daily volume of shares traded in London is in European companies, a business which is at risk of migrating back to the EU unless a separate deal can be reached.

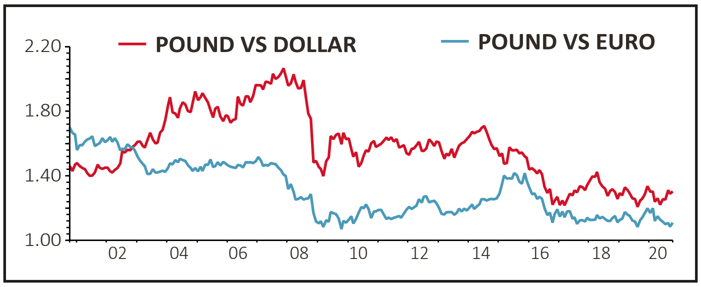
Of the €12.5 billion of shares which changed hands in London in August, €7.2 billion or 58% was in the shares of EU companies according to Cboe Global Markets. Keeping this business depends on the EU agreeing that UK regulations meet its own standards, a finding known as 'equivalence'.

Striking an agreement is by no means guaranteed and there is little time left. Last year the EU withdrew equivalence from Switzerland, putting an end to the trading of European stocks on Swiss exchanges.

Alasdair Haynes, chief executive of **Aquis Exchange (AQX:AIM)**, a pan-European share trading platform, is worried about the impact on liquidity: 'I'm concerned for the industry, it's bad for the end investor and it will make markets worse.' Haynes estimates up to a third of trading now going through London could move to Europe, and Aquis has set up a new platform in Paris.

Considering the size and importance of financial services to the UK economy, compared with say fishing, this issue has received very little airplay but it could mean higher costs and less liquidity for investors.

INVESTMENTS TO MAKE OR AVOID IF THERE IS A DEAL



Our sense is that there is a willingness on both sides to 'get a deal done' which will satisfy Europe and allow Boris Johnson to appease the Leave contingent with a totemic if economically insignificant win, such as a better deal on fishing.

Karen Ward, chief European market strategist at JPMorgan Asset Management, believes sterling will rally around 5% to $1.35, limited by the fact any deal is likely to be 'skinny' and the UK economy will continue to underperform its global peers.

Sources of index revenues

	UK	Europe
FTSE 100	23%	9%
FTSE 250	39%	15%

Source: FTSE, Datastream

A strong pound would negatively impact the FTSE 100 index, where over 75% of company revenues are generated outside the UK but could be good for the FTSE 250 index whose constituents generate almost 40% of their revenue in the UK.

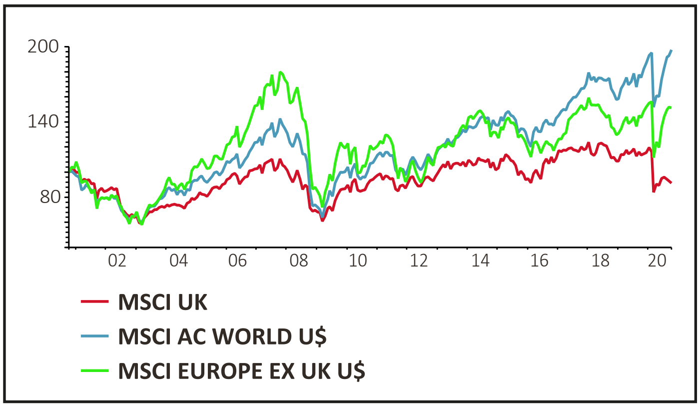
Investors seeking to position themselves for this outcome could buy **Vanguard FTSE 250 ETF (VMID)** which has a low 0.1% annual charge to track the performance of the FTSE 250 index. For example, if the index went up by 5% then this ETF should in theory do the same before charges.

At the time of writing, the biggest companies in the FTSE 250 index were cruise ship operator **Carnival (CCL)**, investment trust **Pershing Square (PSH)** and precision engineer **Renishaw (RSW)**, all of which are predominantly overseas earners or invest in foreign companies.

More relevant to the index from a UK earnings perspective would be stocks such as kitchen seller **Howden Joinery (HWDN)**, insurer **Direct Line (DLG)** and retailer **Games Workshop (GAW)**.

Investors wanting to back a UK stock rally via actively managed funds should look at **Franklin UK Mid Cap (B7BXT54)** which has a good track record of outperforming the FTSE index.

Given how underweight the UK market global investors have been since the referendum, a deal could see a wave of money come into UK stocks. Also, the UK has been one of the worst-performing equity markets this year losing 23% up to the end of September – only emerging markets like Brazil, Russia and Turkey have performed worse – so optically at least it looks cheap.



With more clarity on their trading arrangements, firms which suspended their dividends may feel encouraged to restart them. There may also be a wave of mergers and takeovers as pent-up demand is unleashed.

INVESTMENTS TO MAKE OR AVOID IF THERE IS NO DEAL

If there is no deal, sterling could easily slide up to 10% against major currencies but the reaction of the UK stock indices could be more nuanced.

FTSE 100 stocks with global revenues could increase in price due to the effect of a weak pound on earnings but the hit to the economy – estimated by the Bank of England at 5.5%, with unemployment rising to 7% – would likely weigh on domestic-facing stocks.

Given that approximately three quarters of the FTSE 100 earns money outside the UK, it would be fair to suggest a rally in the index on no deal. If you think no deal is the most likely outcome, buy a FTSE 100 tracker fund such as **iShares FTSE 100 ETF GBP Acc (CUKX)** which has a 0.07% charge.

On a positive note, UK firms have had several trial runs at Brexit so they should at least be prepared for a worst-case scenario. Also, the UK already trades on WTO rules with the US, China, Russia and Australia so companies are familiar with the process but adding Europe to the list would be a major blow as the zone accounted for 43% of UK exports and 51% of imports last year.

In terms of policy support for the economy, the UK's public sector debt has already ballooned with short-term cyclical borrowing thanks to Covid and the Treasury will be reluctant to add further to its long-term structural debt.

The Bank of England has sounded out the banks on the potential use of negative interest rates, and it could expand its asset purchase programme which has so far been largely concentrated on the government bond market.

A combination of negative rates and lower yields would be disastrous for earnings in the banking sector and could likely see lending curtailed, including mortgages, which would have a knock-on effect on housebuilders and consumer stocks.

DISCLAIMER: Editor Daniel Coatsworth owns shares in Vanguard FTSE 250 ETF

Invesco

A CLOSER LOOK AT GOLD MINING COMPANIES AND ESG

James Goldstone
UK Equities Fund Manager
Invesco

Those familiar with my investment approach will know that I have a high conviction, valuation-focused process which seeks to maximise exposure to companies I consider to be the most attractive. I am not averse to deviating meaningfully from the benchmark index which is why you will find that I have used the flexibility to invest a proportion of the portfolios overseas with a meaningful allocation to gold mining companies*.

*16.7% as at end August 2020 across Barrick Gold, Newmont Mining, Agnico Eagle Mines and Wheaton Precious Metals.

I have held gold mining companies in the portfolios for around 3 years, starting with a small allocation that I have increased over time, particularly in the last 18 months. In volatile equity markets they have worked well during the disruption sown by COVID-19, but their main function from a portfolio construction perspective is to potentially protect against increasingly negative real interest rates[1].

The economic issues we now face are being met by increased stimulus, monetary but - crucially - also fiscal, as governments spend more and more to protect jobs and support economic activity. This has widened fiscal deficits and driven money supply materially higher and inflation expectations have increased as a result. In a world of such low interest rates and bond yields, this has pushed real interest rates further into negative territory and is the main reason for the strong performance of gold itself.

The gold mining companies that I hold in the portfolios all have attractive free cash flow[2] (FCF) yields. In fact their valuations are at discounts

[1]A real interest rate is an interest rate which has been adjusted to remove the effects of inflation to reflect the real cost of funds to the borrower and the real yield to the lender.

[2]Free Cash Flow represents the cash that a company generates, after accounting for cash outflows to support operations and maintain its capital assets, which is available to pay to investors in the form of dividends and interest.

Invesco

relative to companies in other "defensive" sectors that we expect to prove less defensive over time. This further strengthens the rationale for these four holdings.

The two biggest positions are in Barrick Gold (6%) and Newmont Mining (4%). Both are listed in North America, have similar market capitalisations of US$53bn and have strong balance sheets. They achieve geographic diversification across 4 continents and more than 15 countries, and diversification by asset across some 30 mines. The assets are at the low end of the cost curve (which makes them less exposed to fluctuations in the gold price making them more defensive) and have long reserve lives that can be maintained at 10 years within current capital expenditure budgets.

The companies have management teams of exceptional quality and experience. Both have strong capital allocation frameworks and have already completed successful mergers and acquisitions which means that an increasing proportion of the FCF mentioned above can come back to shareholders through dividends and share buybacks[3]. In our recent interactions, both have made it clear that shareholder distributions are likely to increase significantly.

When it comes to Environmental, Social and Governance (ESG) this is front and centre for the mining industry and has been a key area in our assessment of the investment case and each of these companies has a strong track record. Investors have pressed for improvement in how mining companies address issues such as climate change, water management, impact on local communities and health and safety for employees and the community. Barrick and Newmont are acutely aware of the importance of these factors and have been actively engaged with investors on this subject for many years.

In 2019 Barrick acquired Randgold Resources. The former Randgold assets are in central Africa where strong engagement and relationships with local communities are vitally important given the contribution the operations make to the social and economic development of the host countries. Mark Bristow, the Randgold CEO, became CEO of Barrick and his long experience devolving responsibility to local management teams and maintaining strong relationships in-country over the years is invaluable to the sustainability of the enlarged business.

Newmont proactively engages with external stakeholders of the business based on inclusion, transparency and integrity. For example, the company operates mines in Australia, where they endeavour to work with communities to ensure that any adverse impacts on the indigenous cultures and history are minimised and improvements are made to local communities.

There is always scope for improvement, whether it be mine safety enhancements through training, technology and automation, or reduced carbon emissions by shifting to renewable energy sources or electric vehicles at the mines. Increased data gathering and analysis will assist in the accurate measurement of the performance of the company against its sustainability credentials and enable us to assess progress against their long-term strategies. Improvement in ESG will be keenly watched by investors and those mining companies that successfully minimise potential problems are in the long run likely to benefit from a lower cost of capital.

The FCF yield is very attractive and although exposure to a commodity price brings inherent uncertainty, these two companies are best in class in so many ways that I believe they have the best risk profile in the sector. This includes the strength of their balance sheets and their corporate governance structures, both of which are a significant focus for me when selecting companies for the portfolios.

[3]A Share buyback refers to the repurchase of shares issued by a company, in the marketplace.

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James Goldstone is manager of Keystone Investment Trust plc and Invesco Perpetual Select Trust plc: UK Equity share portfolio. Each trust has four gold mining company holdings: Barrick Gold, Newmont Mining, Agnico Eagle Mines and Wheaton Precious Metals.

Investment Risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When making an investment in an investment trust you are buying shares in a company that is listed on a stock exchange. The price of the shares will be determined by supply and demand. Consequently, the share price of an investment trust may be higher or lower than the underlying net asset value of the investments in its portfolio and there can be no certainty that there will be liquidity in the shares.

The products use derivatives for efficient portfolio management which may result in increased volatility in the NAV.

The products invest in smaller companies which may result in a higher level of risk than a product that invests in larger companies. Securities of smaller companies may be subject to abrupt price movements and may be less liquid, which may mean they are not easy to buy or sell.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

As a result of COVID-19, markets have seen a noticeable increase in volatility as well as, in some cases, lower liquidity levels; this may continue and may increase these risks in the future. In addition, some companies are suspending, lowering or postponing their dividend payments, which may affect the income received by the product during this period and in the future.

Invesco Perpetual Select Trust plc: UK Equity Share Portfolio

The Directors intend that each portfolio will effectively operate as if it were a stand-alone company. However, prospective investors should be aware that in the event that any of the portfolios have insufficient funds or assets to meet all of its liabilities, such a shortfall would become a liability of the other portfolios. In addition, should the investment trust incur material liabilities in the future, a significant fall in the value of the investment trust's assets as a whole may affect the investment trust's ability to pay dividends on a particular class of share portfolio, even though there are distributable profits attributable to the relevant portfolio.

Important information:

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

For more information on our products, please refer to the relevant Key Information Document (KID), Alternative Investment Fund Managers Directive document (AIFMD), the Supplementary Information Document and the latest Annual or Half-Yearly Financial Reports. This information is available using the contact details shown.

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RUSS MOULD
AJ Bell Investment Director

How to tell if the global economy can keep on trucking

The Dow Jones Transportation index has outpaced its Industrials counterpart in the past year

Regular readers will know this column is a big fan of Richard Russell's so-called 'Dow Theory,' which argues that if the Dow Jones Transportation index is thriving then the better-known Dow Jones Industrials index should flourish too.

In theory, it can only be good news if the share prices of the firms moving goods around the world by road, rail, sea or air are doing well. If something is sold, it has to be shipped.

Conversely, weak transport stocks could mean unsold goods are piling up on shelves or in warehouses and in turn forcing cuts in production and shipments, with the ultimate result that companies cut back on jobs and investment to the detriment of wider economic activity.

It could therefore be a good sign for those investors with exposure to US equities – and stock markets worldwide – that the Dow Jones Transportation index has just barrelled past its September 2018 high and moved to within touching distance of the 12,000 mark for the first time in its history.

ON A ROLL

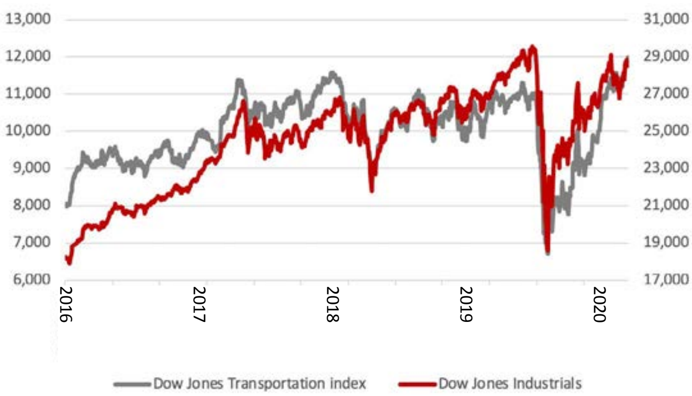
Even more intriguingly, the Dow Jones Transportation index is now up 13% over the past 12 months, while the better-known Dow Jones Industrials is just 7% higher. Dow Theory would suggest that the Transports leading the Industrials is a sign of better things to come.

Yet sceptics will question how this can be, when the recovery from the deep downturn suffered in the first half of 2020 still feels so fragile. The latest updates from Cass Freight Index, which measures monthly freight activity in North America, do not seem to offer much by way of immediate encouragement.

September's reading showed a 1.8% year-on-year decline in shipment volumes. This is the twenty-second consecutive month to show a year-on-year drop and the index actually peaked back in May 2018, as if to imply the US economy was already in trouble even before the pandemic hit home.

Yet the Cass analysis reads in a much more upbeat fashion. That 1.8% year-on-year drop is the lowest rate of decline since March 2019 and the index is

The Dow Jones Transportation index is rising a lot more slowly than the Dow Jones Industrials



Source: Refinitiv data

RUSS MOULD
AJ Bell Investment Director

US freight volumes seem to be recovering

Source: Cass, FRED- St. Louis Federal Reserve database

World trade volumes are recovering too

Source: www.cpb.nl – World Trade Monitor

now 28% higher than its April trough. Moreover, notes Cass, 'we see [the index] staying strong through year-end, as inventories remain relatively lean, and we expect freight to keep moving'.

SHIPPING FORECAST

Cass flags improved consumer confidence, better business sentiment as companies reopen following spring's lockdowns and also improved global trade flows. The final point seems to tally with data made available by the Port of Long Beach, America's second-biggest port after that of neighbouring Los Angeles. Loaded container volumes, for import or export, grew for the third time in four months in August.

This perspective also seems to tie in with the monthly *World Trade Monitor* published by the CPB Netherlands Bureau for Economic Policy Analysis. It too is showing improved momentum in trade flows, even allowing for the still-vexed nature of US-China trade relations and the Brexit talks between the UK and the EU.

A further source of news flow also backs up the case for transport stocks moving higher and that is Copenhagen-quoted AP Møller Maersk. It is the world's largest container shipping company and therefore a fair proxy for global growth.

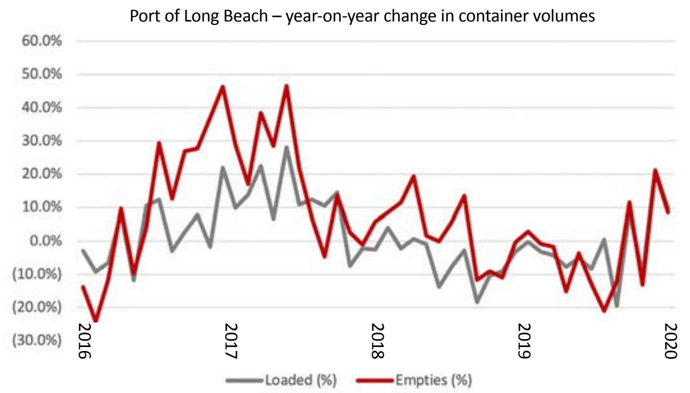
The Danish firm's third quarter trading update (13 Oct) revealed that container volumes were down just 3% year-on-year compared to the 16% plunge witnessed in the second quarter and its shares responded favourably as they reached levels last seen in early 2017.

AP Møller Maersk also raised its earnings guidance for the year, although some of this was for company-specific reasons, such as cost efficiencies, lower fuel bills and higher freight rates.

In addition, volumes are still down year-on-year, just as they are in the Cass, Port of Long Beach and CPB data, so the global economy is far from out of trouble – the International Monetary Fund and World Bank would not have spent their October meetings crying out for more fiscal stimulus and government spending otherwise.

But at least investors can keep an eye on these data points as a quick guide as to whether the global economy is gathering or losing speed.

US container shipping seems to be recovering



Source: Port of Long Beach

Investing in family-run businesses can help you beat the market

We explore the reasons why certain firms have rewarded investors over the long-term

Some of the most respected investors including Fundsmith manager Terry Smith and asset manager Stewart Investors hold the view that family-controlled businesses can be good investments.

The logic is fairly simple – the people running family-controlled companies will have its interests at heart, because they want to ensure the business is around in 10, 50 or even 100 years' time so their children, grandchildren and so on will still have a future running a solid company.

In theory, this means they will be more thoughtful in allocating capital and won't make any rash decisions, which could make them safer in a downturn, enable them to provide more reliable dividends and potentially outperform over the long term.

HARD EVIDENCE

There have been studies validating this hypothesis. Research by professors at the IE Business School, looking at 2,500 European stocks between 2001 and 2010, concluded that there is 'no room for doubt: listed European family businesses created more value for their shareholders during the period 2001-2010'.

Research by Bloomberg in 2015 showed significant outperformance in these types of companies against the FTSE All-Share and colossal outperformance against the FTSE AIM index.

In April this year, a few weeks after the low point of the big market sell-off, research firm AlphaValue identified 47 family-influenced firms in the Stoxx Europe 600 Index. Just three of these companies scrapped or cut their dividend, meaning 94% maintained their payout. By comparison, 75% of the wider index chose not to cut dividends.

INVESTMENT OPTIONS

Many family-owned firms are big household names listed on European markets including L'Oreal, Heineken, H&M and Volkswagen.

On the London market there are plenty of examples including Primark owner **Associated British Foods (ABF)**, clothing retailer **JD Sports (JD.)** and fund management group **Schroders (SDR)**.

Given the apparent benefits of family-controlled firms, a number of high-profile fund managers use family-controlled companies as one of their criteria for helping to pick stocks.

For example Richard Pease, manager of **CRUX European Special Situations (BTJRQ06)**, mostly invests in companies where the founding family or original entrepreneur hold a large stake, while around 63% of the portfolio of **Fundsmith Emerging Equity Trust (FEET)** is held in family-controlled businesses.

FAMILY FUND

Investors seeking a fund purely focused on this theme should note the recent launch of **Pictet-Family (BGY5SC0)**, which debuted in June and is a repositioning of what was the Pictet-Small Cap Europe fund.

Pictet thinks this approach of investing in family-controlled firms could deliver strong returns going forward, a theory supported by a back-test it conducted which showed a 56% outperformance compared to the MSCI ACWI index between 2007 and the middle of June 2020.

It defines a family business as a listed company where a person, often the founder, or a family hold a minimum of 30% of the voting rights. Pictet says this provides an investment universe of around 500 companies globally.

The family can be by blood or marriage and the stake can be held through a foundation or another vehicle

The family can be by blood or marriage, it says, and the stake can be held through a foundation or another vehicle. It chose 30% as the threshold as this is where a shareholder would effectively have the casting vote and thus control of the company.

THREE CHARACTERISTICS OF FAMILY BUSINESSES

Rania Labaki, a director from business school EDHEC, says:

1 Family businesses often prefer self-financing and have a low dividend payout rate. Excess cash flow is used primarily for long-term investments with a liquidity reserve which seems to exceed that of non-family firms.

2 Financing from banks can be relatively more accessible given the long-term and trusting relationship developed with banks that are often historically linked to the family.

3 Family businesses have a greater capacity for innovation than other businesses, but also a willingness to innovate that seems more marked in times of crisis, which they see as signs of opportunity.

RISKS TO CONSIDER

While the advantages of investing in these companies seem pretty clear, there are some risks to be aware of, such as related party transactions (where a family-owned company could buy a business from a relative at a grossly inflated price), excessive compensation or expropriation of assets.

But Pictet-Family co-manager Cyril Bernier insists there are ways to mitigate such risks.

He explains: 'We look for bodies on the board that ensure protection for minority shareholders – independent committees like audit, remuneration, and nomination committees, to ensure the family's interests are aligned with the interests of investors.

'We also only invest in family companies where there has been no controversy in the family. And we look for a strong financial culture, a strong culture which supports minority investors.'

ASHMORE EXAMPLE

Among the UK stocks in Pictet's fund is FTSE 250 fund group **Ashmore (ASHM)**, which he describes as a leader in emerging markets with good governance and long-term growth opportunities.

Set up by chief executive Mark Coombs in 1998, Bernier says Coombs has been 'developing a strong culture' at the business and aligning the company with the interests of minority shareholders. He also notes that Coombs has 'plenty' of his personal wealth invested in the firm.

It's worth noting that family-controlled companies tend to be more heavily weighted towards the consumer discretionary, consumer staples and communications sectors, and so don't necessarily mirror the wider market.

By **Yoosof Farah**
Reporter

Key points to understand about ethical investments

Retail investor interest in ESG products is heating up, so make sure you understand the different ways they work

It's impossible to ignore the tremendous attention to environmental matters that has emerged across the globe in recent years.

Campaigners and activists have put green credentials on the priority list for most politicians, with Boris Johnson recently reinforcing his pledge to make the UK greener with £160 million of investment in wind energy.

The Covid-19 crisis may have overshadowed the activities of Greta Thunberg and co, but it's also underlined the economic damage that can stem from mishandling environmental issues.

This looks to have spurred retail investors to plough money into responsible funds this year, which saw £2.5 billion of inflows in the second quarter. That compares with just £0.8 billion in the same period last year. However, less than £3 in every £100 invested in UK-based retail funds is held in the ethical sector though, which means there's still plenty of scope to attract new eyeballs.

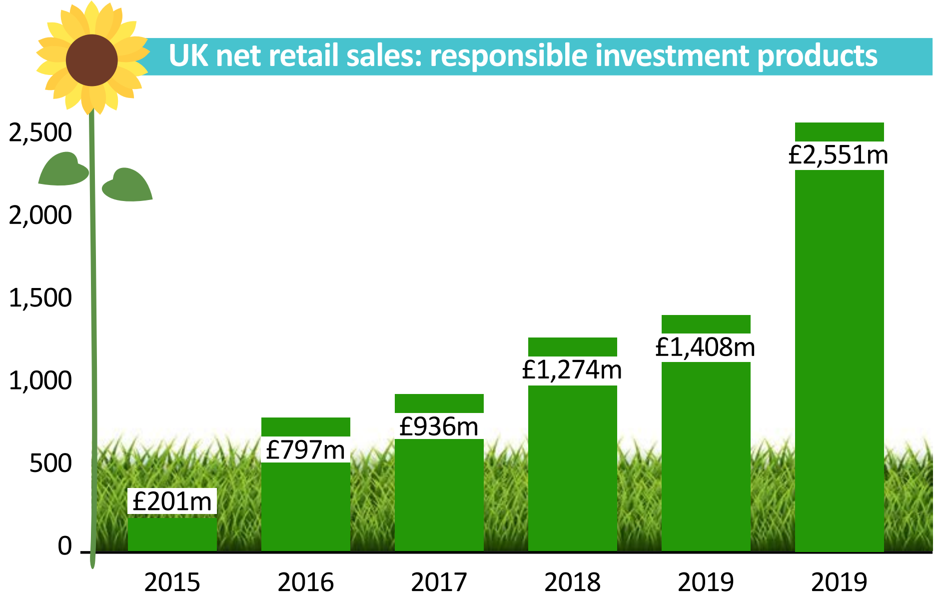
The BP Gulf of Mexico oil spill was an ecological catastrophe

E, S AND G

Environmentally sound credentials are typically one of three main qualities responsible funds seek when choosing companies in which to invest.

They will also look for companies that are making a positive contribution to human society, for instance by improving public health.

The third plank of the standard ESG approach is robust governance, where failings have resulted in scandals like the BP Gulf of Mexico oil spill, and more recently the Volkswagen emissions scandal.



Source: Investment Association

POSITIVE AND NEGATIVE SCREENING

Responsible funds come in many different shapes and sizes, but there are broadly two different approaches which fund managers adopt.

Some funds like **Aegon Ethical Equity (0745088)** screen out investments which they view as ESG transgressors.

Typical examples of companies excluded from such funds would be tobacco companies, arms manufacturers and fossil fuels. This approach is often referred to as negative screening.

The second approach, taken by funds like **Liontrust Sustainable Future Growth (3002876)**, seeks to invest in companies which are actively making a positive contribution to a range of ESG themes such as improvements in energy efficiency or providing affordable healthcare. In the industry this process is called positive screening.

TRACKERS AND SPECIALIST INVESTMENTS

Traditional tracker funds don't have any ESG screens and simply allocate money to stocks in an index passively.

If **Royal Dutch Shell (RSDB)** is 5% of the index, a FTSE 100 tracker is simply going to place £5 out of every £100 invested into Shell stock.

Fund management groups that run tracker funds can take an activist approach to engaging with companies on ESG matters, but they lack the final sanction of upping sticks with their money.

There are some funds which track specific ESG indices, produced by the likes of FTSE and MSCI. Much like with an active fund, investors should check the ethical criteria to make sure investment is aligned with their own goals – this time it's the composition of the index they need to look at, which the fund simply mirrors.

More specialised funds can provide purer exposure to specific themes investors may want to get behind. For instance, the names of the **iShares Global Clean Energy ETF (INRG)** and **Greencoat UK Wind (UKW)** speak for themselves. Clearly the more specialised the theme, the less diversified the portfolio, and the more risk investors must be willing to accept.

WILL ETHICAL FUNDS OUTPERFORM?

There have been no definitive studies which show that responsible funds are bound to outperform traditional funds, or vice versa.

In any case looking in the rear view mirror isn't going to be a good guide to the future, seeing as the increasing scrutiny of ESG qualities means we could see more and more investment flowing to those companies doing the right thing, thereby boosting share prices.

Traditional funds are also paying more attention to ESG matters as part of their investment process.

Based on current trends, the end state for ESG metrics is probably a pocket in the bag of tools used by fund managers to evaluate investments, alongside

valuation ratios, earnings growth and balance sheet strength, among others. That means even funds which aren't for dedicated ethical investors may end up benefiting from any ESG tailwinds.

THE RISKS OF INVESTING RESPONSIBLY

While the jury is therefore out on the matter of performance, the question of risk is more clear-cut.

> *"Sometimes it's important not to let the perfect be the enemy of the good"*

Responsible funds will look very different to the main indices of the markets in which they are investing. This isn't necessarily a bad thing, in fact it's the cornerstone of high conviction active management, but it does mean that investors need to be willing to tolerate significant periods of underperformance relative to the index.

Responsible investors should also be alert to concentration risk, as a purely ethical portfolio may leave them heavily exposed to specific areas, such as smaller companies and emerging technologies. A pragmatic way to mitigate this problem is to combine responsible funds with traditional funds, to produce a more diversified portfolio.

Clearly this is a halfway house which will undermine the point of investing ethically for some investors. But for those who have responded to the threat of climate change by reducing meat consumption or foreign holidays, without eliminating them entirely, compromise will be a more familiar road to tread. Sometimes it's important not to let the perfect be the enemy of the good.

FUTURE OF RESPONSIBLE INVESTING

For many years the dial didn't really twitch on the amount of retail money invested ethically. Time will tell whether 2020 is a blip or the start of a more sustained trend.

In a world where **BP (BP.)** has promised to reduce carbon emissions to net zero by 2050, and the cigarette manufacturer Phillip Morris has committed to delivering a smoke-free future, there's evidence that pressure is already beginning to bear fruit.

DISCLAIMER
Editor Daniel Coatsworth owns shares in iShares Global Clean Energy ETF

By **Laith Khalaf**
Financial Analyst

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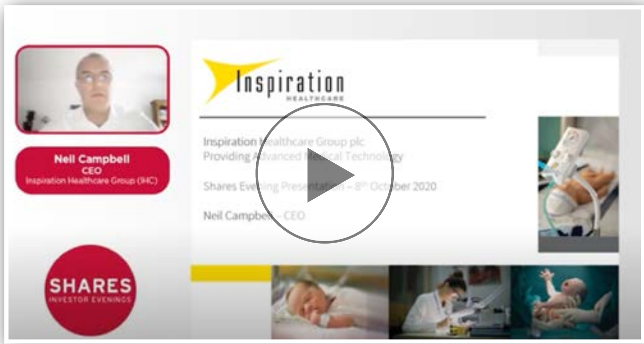
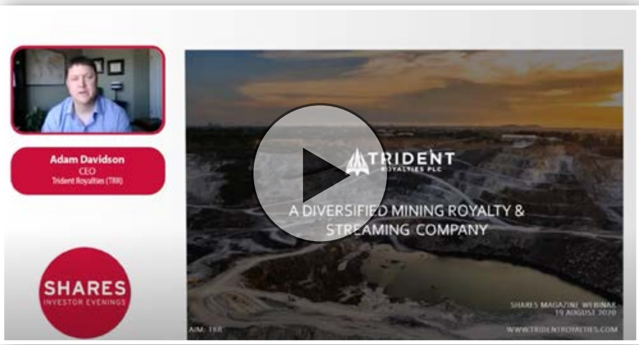


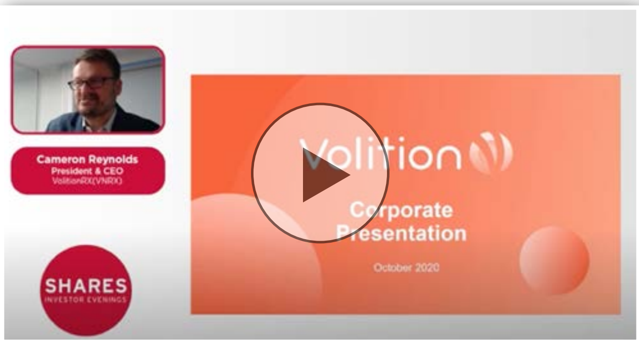
Inspiration Healthcare Group (IHC) – Neil Campbell, CEO

Inspiration Healthcare Group is a global supplier of medical technology for critical care, operating theatre and home healthcare applications. Our mission is to provide high quality innovative products to patients and caregivers around the world.



Trident Royalties (TRR) – Adam Davidson, CEO

Trident Royalties plan to rapidly establish itself as a diversified mining royalty and streaming company, providing investors with exposure to base and precious metals, bulk materials (excluding thermal coal) and battery metals.



VolitionRX (VNRX) – Cameron Reynolds, President & CEO

VolitionRX is a clinical-stage life sciences company. The company is engaged in developing blood-based diagnostic tests for detecting and diagnosing cancer and other diseases.

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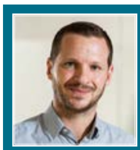
EU residents face UK bank account problem

Expats might encounter issues when trying to access their pension money

I live in the Netherlands and currently have my drawdown pension paid into my UK bank account. However, I've just been told my bank plans to stop offering banking services to EU customers. What options do I have?
Anonymous



Tom Selby
AJ Bell
Senior Analyst says:

This is a situation facing thousands of expats currently living in the European Union and comes as a result of the uncertainty of 'passporting' rights resulting from Brexit.

UK banks have been allowed to provide services to customers in the European Economic Area (which comprises the EU plus Iceland, Liechtenstein and Norway) without having to be directly authorised in those states.

However, with the UK now out of the EU and passporting set to expire once the Brexit transition period ends on 31 December 2020, some major UK banking names – including Lloyds, Halifax and Barclays – have already decided to pull the plug and inform customers they will no longer offer banking services to people living in the EU.

Others have kept their cards close to their chest, creating huge uncertainty for EU residents who have their income paid into UK bank accounts – including retirement incomes such as drawdown.

WHAT ARE THE OPTIONS?

There are a number of avenues you can try ahead of your bank account being closed.

Firstly, speak to your bank and see if there is any way to appeal the closure. This might not be possible as they could insist you'll need a UK residential address to retain the account, but it's still worth doing to make sure there are no other viable options.

Secondly, you could consider switching to a UK bank that still allows accounts to be held by residents of the country you live in. However, you need to be prepared for the possibility that a bank which accepts expat customers today might change its policy tomorrow. Despite the uncertainty, this may be the best option available to you.

Finally, you could see if you can have your drawdown pension paid into a local bank account. This is the case for your state pension but many pension firms won't allow it. You'll need to speak to your provider to find out if this will be possible.

You should also be aware that this income would be subject to currency conversion risk, meaning the local spending power of the money you receive could fluctuate depending on movements between the pound and the euro.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **editorial@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

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Check you won't lose out by transferring.

How to calculate enterprise value and when to use it

It is particulary important in takeover situations

Enterprise value (EV) is often underappreciated by investors who tend to focus on the market value of a company. It is arguably a better way to value a business than market capitalisation (also known as market cap) because it takes account of debts, preferred shares, minority interest and cash.

Put simply, it is the value of the whole business, not just the portion financed by shareholders. In calculating EV, the former items are added to market cap while cash items are deducted.

This rounded view is why enterprise value plays a crucial role in takeovers.

WHY DO THE OTHER BITS MATTER?

If someone is looking to buy a business, they need to work out the sum of the liabilities to purchase 100% of a company's cash flow.

Preferred shares pay fixed dividends and take legal priority over payments to ordinary shareholders. They are considered more like a debt instrument.

Minority interest refers to situations when a company owns less than 50% of a subsidiary. Someone looking to buy the parent company and control 100% of the cash flow would also have to buy out the other shareholders of the subsidiary.

Looking only at a company's market capitalisation can sometimes give a misleading picture of the real size of a business. For example, energy supplier **Centrica (CNA)** has a market cap of £2.4 billion, but adding net debts of £3.5 billion brings its EV to £5.9 billion, two and a half times bigger than its market cap.

At the other extreme is engineering firm **Costain (COST)** which has a market cap of £108 million, but net cash of £140 million, giving the company a negative EV, implying the operating assets of the business are worthless.

Fantasy miniatures company **Games Workshop (GAW)** is an example of a business which doesn't rely on borrowed money to operate. It generates a lot of cash and produces high returns on the operating assets it deploys, more than enough to maintain operations, invest in its future growth while also paying dividends to shareholders.

Therefore, Games Workshop's market cap represents the true size of the underlying business. Market cap is calculated by taking the latest share count which can be found in the company's annual report and multiplying by the latest share price, (33 million shares and £106 per share) resulting in £3.5 billion of value as determined by investors.

Whenever there is a change in the number of shares in issue, companies are required to update the market with the correction information, so investors are armed with the latest data to calculate the market cap.

USING ENTERPRISE VALUE

Enterprise value crops up most often in various valuation metrics such as EV to EBITDA and EV to sales ratios. The main advantage is that investors can make like-for-like comparisons of companies with different capital structures operating in the same industry. Using EV across different industries can give unreliable results because of different margins and capital requirements.

Private equity investors popularised the use of EBITDA during the leveraged buy-out boom in the 1980s. They used it as a proxy for cash flow when appraising acquisitions because it ignored non-cash items like depreciation and amortisation. This made cash flow look better and allowed investors to justify using higher amounts of debt financing.

However, depreciation is a real business expense which can be significant for capital intensive industries. Depreciation relates to capital expenditures which are required to maintain operations.

Let's look at an example using EV to EBITDA and compare it with the traditional price to earnings ratio (PE). Pubs group **Marston's (MARS)** looks cheaper relative to **J D Wetherspoon (JDW)** and **Young's (YNGA:AIM)** on the basis of PE, but much more expensive through the lens of EV, because of the different financing structures.

The enterprise value for Marston's is seven times its market cap compared to around two times for Wetherspoon and Young's. All these groups have significant asset backing through ownership of freehold properties which must be acknowledged when looking at each company's capital structure and debt.

Company	Market Cap £m	EV £m	Trailing PE	EV/EBITDA
Wetherspoon	1,157	2,558	12.0	10.8
Marston's	284	1,983	4.8	18.1
Young's	485	765	11.4	10.8

Source: Stockopedia, Refinitiv

Investors should be careful when using EBITDA in capital intensive industries. It can be better to use more traditional measures like net operating cash flow, which takes into account changes in working capital and capital expenditures.

Investors should be careful when using EBITDA in capital intensive industries and use more traditional measures like net operating cash flow

Another sector where Investors need to apply some caution is when looking at certain software businesses, especially where a company capitalises development expenditures, rather than expensing them. The difference between EBITDA and cash flow can often be significant.

By **Martin Gamble**
Senior Reporter

KEY

- Main Market
- AIM
- Fund
- Investment Trust
- Overseas Share
- ETF

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

23 October: Avation. **27 October:** Quiz, Renalytix AI. **29 October:** Proactis.

Half year results

27 October: First Derivatives, Whitbread. **29 October:** Angle, BT.

Trading statements

27 October: ContourGlobal, Plus500. **28 October:** Gem Diamonds, Ibstock, Next. **29 October:** Helios Towers, Indivior, Royal Dutch Shell, Smith & Nephew, WPP.

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Company Registration No: 3733852.

All chart data sourced by Refinitiv unless otherwise stated