In its twenty-third year
ISSN 1476 895X
September 2022

TMI

"Relative strength is the only growth variable that consistently beats the market"

The Momentum Investor

STOCKMARKET NEWSLETTER

Authoritative Independent Monthly Share Selections using Technical & Fundamental Analysis

This Issue

Loungers — Buy
Accelerating new openings from 24 to 32 as it eyes 500 outlets

4Imprint — Buy
Promotional products group enjoys two massive eps upgrades

AG Barr — Buy
Owner of IRN-BRU has £150m war chest for acquisitions

Babcock — Buy
Net debt falling faster than expectations

ME Group (Photo-Me)
Announces 6.5p special dividend

Ten Entertainment
Another 'beat' triggers 17% upgrade

Reach
Plus products now over 30% of Digital

Restaurant Group
Acquires Mexican restaurant chain

Elementis
Results near top end of expectations

- - -

FTSE-100: 7466
FTSE-All Share: 4131
Small-Cap: 6627

Next issue on Saturday 24 September

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Loungers

Sector: AIM, Travel & Leisure. Share Price: 207.5p Epic Code: LGRS

Key Data

Address:	26 Baldwin Street, Bristol, BS1 1SE
Telephone:	01179 309971
Shares in issue:	103m
Market Capitalisation:	£213.7m
Next Results:	Interims: December

In the 80s and 90s, a pub chain or restaurant rolling out a concept was enough to get the pulses racing because management have a fixed target range of new openings each year. During my personal investment journey I've witnessed outstanding gains from the likes of Pizza Express and Ask (helped by huge mark-ups on the cheap pizza base and toppings) while JD Wetherspoons (pubs) and Luminar (nightclubs), founded by larger than life characters, Tim Martin and Stephen Thomas, respectively and even franchise roll-outs such as Domino's Pizza have paid off with handsome multi-bagging gains. During moments where the market is buoyant their respective PE multiples can stretch as high as 40 or even 50 times (in Luminar's case) but the current sell-off has thrown up outstanding value opportunities and one example is Loungers, owner of a chain of UK-based casual dining outlets whose recent full year results, for the year ended April, were record breaking and ahead of forecast.

Underlying EBITDA 40% above pre-Covid

While results included business rates and VAT holidays, as well as furlough payments, which of course won't be repeated, Loungers' trajectory is very much on the up. Peel Hunt estimates that underlying EBITDA (pre lease adjusted) would have been up c. 40% on FY'19 (the last year without interruption from Covid) while another way to display the terrific momentum can be shown in forecasts, which expect eps of 9.1p, 10.7p and 12.9p between FY'23-'25. That leaves the prospective PE standing at 22.8, dropping to 16.1 two years out, which looks good value, particularly when considering four important factors.

Four reasons shares should re-rate

First, Loungers is the pre-eminent player in the casual dining sector and is proverbially shooting the lights out, posting cumulative like-for-like sales growth (excluding the VAT relief) of 14.2% between FY'19-'22, outperforming the Coffer Peach Business Tracker, the established industry sales monitor for the pubs and restaurant sector, which fell 4.7% over the same period. In the most recent 12 weeks between 18th April - 12th July growth has further accelerated to +17.9% versus +2.7% for Peach Tracker.

Second, Loungers is extra ordinarily cash generative and last year reduced net debt, excluding leases, from £47.5m at April '20 to just £2.7m and therefore while a PE ratio analysis doesn't illustrate this advantage, a better bet is that its Enterprise Value (i.e. market cap + debt or minus cash) / EBITDA is just 4.7x. Peel says that represents "the largest EV / EBITDA de-rating in the hospitality sector and compares to the 13.3x Loungers enjoyed shortly after it floated in May 2019.

"At least 500 outlets"

Management estimates that between its two brands, *Lounges* and *Cosy Clubs*, it could grow to at least 500 outlets in the UK and while we may be staring down the barrel of a recession, that in itself has thrown up much better opportunities in terms of rental charges, expansion opportunities and even pricing, when its less robust competition goes bust. As a result management has upgraded its annual growth target for new openings from 24 to 30-32 which, given it still only has 200 outlets, provides significant runway for future expansion. And, fourth, as I explain below, new openings are generating outstanding returns on investment, in some cases generating over 60% cash return on capital invested.

History

Loungers was founded in 2002 by three friends who opened their first neighbourhood café-bar in North Street, Bristol. Historically the best "roll-out" businesses tend to expand during downturns when commercial property is cheap and Loungers was no exception; during the global financial crisis it expanded from nine 'Lounges' sites in September 2008 to 38 by 2012 and after private equity group, Lion Capital, took a majority stake in December 2016 (it still holds 26.1%, with the founders and CEO Nick Collins holding a combined 13.2%) it accelerated again, helped by the addition of a second brand, Cosy Club.

By the time it had floated on AIM at 200p in April 2019 it had reached 146 outlets and despite the Pandemic it has now reached 201 (169 Loungers, 32 Cosy Clubs).

Hybrid concept sweats assets harder

Loungers describes itself as a neighbourhood café / bar combining elements of a restaurant, British pub and coffee shop culture. There are currently 169 sites trading in the Lounges format, with the sites characterised by informal, unique interiors including colourful wall paper, loads of prints and mirrors on the walls, soft seating / sofas and music making for a warm, comfortable atmosphere, often described as a home from home. It's somewhere to go for a coffee after the school run; for others it's a place to catch up with friends; a place for an informal meal or even a celebratory night out.

This flexibility encourages footfall throughout the day and night and ensures it sweats its fixed assets as hard as possible. CEO, Nick Collins, who I met with over the month, gave the example of its Lounge in Sittingbourne, which opened in October 2020. While its competition usually relies on the weekend trade, Sittingbourne, generated average weekly sales of £3,500 on Mondays, and £4,000 on Tuesday and Wednesdays, before peaking at £8,000 on Saturdays.

Meal for less than a tenner

Value for money is a core tenet and customers can eat a good quality meal for less than £10. Average spend is not disclosed because customers often sit for a while and place multiple orders. Menus include classics such as all-day breakfast and burgers, alongside tapas dishes and sharing plates. Food and drink sales are evenly split 50:50, with alcohol almost 30% sales.

Loungers has never felt the need to operate discount codes or schemes but it does run selected promotions around special occasions (such as Valentine's Day) and runs regular promotions such as "Cheeky Mondays" and "Tapas Tuesdays" designed to drive footfall on quieter or more competitive nights.

It's a truism that customers vote with their feet and 67% of existing ones visit at least monthly and 25% weekly.

Second leg established

What sets Loungers apart from its peers is that management have also established a second brand, Cosy Clubs (32 outlets), which will make it easier to attain their 500+ site goal, given that they can co-exist within a reasonable radius of Lounges sites without cannibalising sales. Cosy clubs are more formal bars / restaurants offering reservations and table service and boast a "wow factor" as they are often located in listed buildings to create a sense of occasion and display lots of period fixtures and fittings. While they also offer a Lounges-style broad all-day menu offering, there is more of a bias towards alcohol (41% sales) and evening trade (49%).

AG Barr (BAG), 538p

History has shown that brands at the premium end of the market offering excellent value do well in a recession as households substitute eating out in favour of more luxurious, premium supermarket lines for home consumption. One example is soft drinks manufacturer and distributor AG Barr, best known for its IRN-BRU brand, which has upgraded guidance three times in little over a year, while its latest update confirmed a 19% increase in like-for-like sales in the six months ended July.

The group was founded in 1875 when Robert Barr transformed a family cork cutting business into one producing and selling aerated waters. The first drink was launched as Iron Brew (now IRN-BRU) in 1901 and was passed down from one family member to another until 2004 when current incumbent, Roger White, ex Rank Hovis McDougal (now Premier Foods), who I met with over the month, took over as CEO and proceeded to make several acquisitions to add new legs in faster growing segments.

The flagship brand, IRN-BRU (41% group sales), is an orange coloured carbonated soft drink made to an original secret recipe which contains 32 flavours. Folklore has it that in 1901 steel workers working on the re-building of Glasgow Central Station were drinking too much beer to quench their thirst. So, AG Barr brought them a tonic-like drink made with caffeine, quinine and sugar that could get them through a hard day's graft. 'Iron Brew' was born and the rest, as they say, is history. These days IRN-BRU commands an 11.5% share of the soft drinks market in Scotland and 2.5% in the UK as a whole. Diving deeper, it has double the share in the North of England relative to the South and is increasing the latter through incremental gains in shelf space by increasing formats e.g. adding 6 and 24 packs to standard 2 litre bottles, marketing to build brand awareness and new products. The latter, which include sugar free, extra (higher flavour), energy and an IRN-BRU 1901 heritage premium drink, now contribute 45-50% of IRN BRU sales. White says this strategy has delivered sales growth 2-4% above the market.

Just over half its sales are derived from supermarkets and discounters with the balance (c. 40% sales) from convenience & impulse such as corner shops, garages and travel outlets whilst there is only a small contribution from bars and restaurants. The "impulse" category largely disappeared during the pandemic but the bounce-back has been swift. Obvious headwinds come from rising costs - R-PET (recycled plastics), packaging (aluminium, paper), fruit (mangoes, passion fruit) and energy but the group has recovered most through "high single digit" price rises and cost cutting. What is exciting now is the opportunity to push additional products through the same channels and several acquisitions have been made including exotic fruit drinks firm, Rubicon (20% revenue) for £60m in 2008 and premium cocktails group, Funkin (which cost £16.5m) in 2015. Most recently it took a 60% stake in MOMA foods, which makes healthy porridge, oat milk and granola bars.

Rubicon, centred in London and the South East, has performed particularly well, with the coconut water and whole-fruit based carbonated drinks markets having grown 15-20% CAGR since acquisition. Originally focused on wholesale cash and carry serving the impulse market, it's also leveraged Barr's sales channels to expand into grocery and being popular in the African and Caribbean community it's often found in the world cuisine aisle in supermarkets, helped by new products including Rubicon Raw Energy and Rubicon Spring (water) and it grew 40% last year.

Meanwhile, Funkin (15% sales), which offers fruit purees, cocktail mixers and syrups, has improved Barr's access to the food services sector. It sells high quality drink ingredients (purees, syrups, mixers) to bars and their trained mixologists, complemented by ready to drink cocktails sold in the ambient section of supermarkets, convenience stores and online. The balance comes from Barr Flavours (12%), comprising lemonade, cream soda, cola and smaller brands & franchise partner agreements such as KA, Strathmore water; Simply; Sun Exotic; Bundaberg; Snapple; and San Benedetto.

With a £68m net cash pile and un-used debt facilities, White says there's firepower of over £150m ready for further acquisitions. High growth areas he likes include functional products, i.e. drinks with vitamins and minerals to replace something the body's lost or add nutrients, Lucozade being the obvious yardstick. Other potential niches include caffeine drinks (think Red Bull, Monster), sports drinks and plant-based products (oat milk etc.).

Brokers expect eps to increase from 25.1p to 30.8p in the year ended 31 January, yet with the shares having fallen from a pre-pandemic peak of 980p to the present 538p, they trade on a prospective of just 17.8. *I am a buyer.* TMI

Babcock (BAB), 340p

Back in October 1962 when the Cuban missile crisis came within a whisker of starting World War III, the UK still spent as much as 7% of Gross Domestic Product (GDP) on defence spending but as part of the so-called peace dividend, that has fallen to just 2%. But the worm has now clearly turned and global military spending has topped US$2 trillion for the first time after seven years of increases. And following on from Ukraine, fears of a conflict with China are also growing, so it's no surprise UK defence stocks have rallied. However, one that has largely missed out has been Babcock, best known for maintaining UK nuclear submarines and surface ships and which generates around half its sales from the UK's Ministry of Defence. Right now investors are blinkered by Babcock's historical indebtedness, exacerbated by its acquisition of Avincis, a provider of helicopter and fixed wing services for the medical, search & rescue and oil & gas industries, shortly before the bottom fell out of crude oil. But under the leadership of CEO David Lockwood it's undergone a significant restructuring (saving £40m p.a.) and results for the year ended March came in ahead of expectations. Most noteworthy was that net debt including operating leases has reduced by c. £900m to £968m or £535m excluding leases, following five disposals, the most recent being remnants of Avincis for £115m, which will complete later this year. By FY'24 the latter is expected to have fallen to just £339m or 1.1x net debt / EBITDA. At the same time JP Morgan Cazenove forecasts eps to increase from 27.3p to 33.3p, 40.1p and 46.7p – growth of 71% in three years.

By division, Marine (profit +22% to £98m last year) is the largest and comprises a collection of long life contracts including Future Maritime Support Program worth £3.5bn running to 2026, which provides through life engineering management and support for the Royal Navy from its bases in Clyde and Devonport. It's also building Type 31 frigates, a general purpose warship, at Rosyth in Scotland and these have tremendous export potential. Elsewhere it provides equipment support and weapons handling and launch systems for aircraft carriers and submarines and has a great opportunity to win significant business from AUKUS (the new collaboration between Australia, US and UK to protect their interests in the Indo-Pacific), which is expected to order at least eight nuclear-powered submarines. Broker Liberum reckons Babcock is well-placed because larger rival BAE Systems is likely to have capacity constraints due to its work on the Dreadnought and Astute battleship classes.

Next down is Nuclear, which operates and maintains the four Vanguard Class submarines that make up the UK's nuclear deterrent. It also provides re-fuelling and extensive mid-life refurbishments for nuclear and non-nuclear subs. Although profit fell 28% to £62.4m, largely due to a contract write-off in defence, prospects are good, with Liberum estimating an £85 billion 10-year addressable market across UK defence and civil nuclear defence, including £23 billion in submarine support, and a £20 billion international opportunity in Japan, Canada and Spain.

At Land, its other main division (profit +20% to £58.8m), Babcock looks after the MoD green fleet (30,000 armoured vehicles), white fleet (15,000 vans) and provides training and fleet management for the Royal School of Military Engineers and London Metropolitan Police and Fire Brigade. Liberum says the UK land market is worth £16 billion over the next 10 years while internationally there's £30 billion up for grabs, with Babcock a new entrant to the international vehicle support and training markets.

Babcock is trading on a prospective PE of 10.2, falling to 7.3 two years out, which looks too mean and JP Morgan Cazenove has a 510p price target. *I am a buyer.*

TMI

Rapid payback on capital

One of the things I like about Loungers is that new outlets generate strong investment returns. A new Lounge costs £735,000 with Cosy Clubs £1m and they take six and 12-18 months, respectively, to reach sales maturity. Average weekly gross sales for last year's openings was £30,600, while returns on capital are said to be running at over 30%.

As Collins says, while other competitors often sign up to high rental sites to please investors in order to hit mandatory new openings targets the subsequent downturn often forces these sites into loss.

Rental costs below 6% sales

He has a rule that rental costs as a percentage of sales must be below 6% and previously has been forced to ignore highly attractive locations including in Greater London and other affluent areas to achieve that. However, one development playing into Loungers hands is that the cost of living / Ukraine crisis has exacerbated the softness in commercial property rents previously caused by Covid-19 to present once in a lifetime opportunities. Landlords are now falling over themselves when presented with a strong, well-financed operator like Loungers and are offering it long-term leaseholds (typically 25 years, break after 15) with rent free periods of 18 months up to 29 months and this has driven its rent to sales down to just 5.5%, comfortably the lowest in the industry.

As an example of a plum location now within its reach, Collins highlights Ealing, West London, which opened earlier this year, with a rental of £80,000 down from £140-£160,000 and Collins says there are at least 45 potential sites now at affordable rents in Greater London alone.

Accelerate to 30+ openings

Crucially, its low rental model also provides flexibility on where it opens; last year's openings included smaller towns (Matlock, Pontypridd); larger towns (Basildon, Shrewsbury); Greater London (Ealing); Retail Centres (Fosse Park, Leicester); and coastal locations (Aberystwyth, Bognor Regis). In the main, they are converting old retail units and banks into Loungers sites to benefit from busy footfall areas.

The sixty four thousand dollar question is how many outlets can it open? The low rent model means its minimum catchment area tends to be a small town with 12,000 people, says Collins, while it's already crammed 12 outlets into Birmingham's suburbs including three on the same road without any dip in performance.

While the official target is 500 (400 Lounges, 100 Cosy Clubs) Collins notes that JD Wetherspoon has over 800 pubs, Starbucks has 1,000 coffee shops and Costa has over 2,000 – and some Lounges trade on streets with no Spoons or Costa! So in reality the potential is far greater than 500 outlets.

In response to this opportunity management has expanded its opening programme from 24 to up to 32 outlets. The pipeline is said to be strong and at least 30 are expected to open this year.

Efficiencies offsetting cost pressures

Sceptical investors might be concerned about the general spike in running costs but Loungers is faring better than most. True, food and drink have risen 4-9% but these have been mitigated by menu evolution and product switch (e.g. taking lamb off the menu after a 14% rise) while scheduling efficiencies are offsetting wage inflation (6-8%+). Serendipitously, the CFO has hedged utilities out to September 2024, locking in zero inflation.

Loungers has in any case launched several projects to maximise greater efficiencies including an order at table App, now accounting for over 40% sales, which has yielded higher average spend and faster ticket processing times; introduced a kitchen management system converting paper tickets to screens and providing useful intelligence on how long dishes take to process (there are only 40 outlets still to be converted now); and a move to central distribution (cutting 4-5 suppliers to just one lorry delivering three times a week).

Upgrades likely

Although Peel Hunt has chosen not to upgrade at this point, this conservatively reflects its concern over cost inflation. I think the broker's stance is unsustainable; cost rises will at some point abate while the hike in new openings should ensure a 'beat' to estimates. *I am a buyer.*

TMI

4Imprint

Sector: Media | Share Price: 3725p | Epic Code: FOUR

Key Data
Address: 25 Southampton Buildings, London, WC2A 1AL
Telephone: 020 370 99680
Shares in issue: 28m
Market Capitalisation: £1.04bn
Next Results: Finals: March

4Imprint, which distributes promotional products, such as stationery, mugs and T-shirts, was originally added to Trader Portfolio 1 at 237p in March '12 and after we took part profits at 1940p (in February '18) it went on to peak at over 3500p in the months before the Pandemic hit, making for an almost fifteen-fold gain at the high! Shortly afterwards it fell through our stop-loss as Covid-19 ravaged its markets but this year it has undergone a spectacular renaissance.

In May analysts were obliged to raise eps forecasts by a barnstorming 41% to 156 cents thanks to "a very strong performance in the first four months" while two subsequent upgrades caused eps to be raised another 45% to 225.9 cents (186.7p) with pretax profit reaching US$83.7m. That compares with its previous peak in FY'19 of 152.4 cents and US$54.7m pretax. But I think there could be even more fireworks for investors and one broker, Barclays, has already raised its price target to £48 and believes that current year pretax profit could ultimately reach US$100m-US$110m if first half revenue growth is sustained in the mid-teens. Under that scenario its price target would rise to £81.

Disposals released huge potential

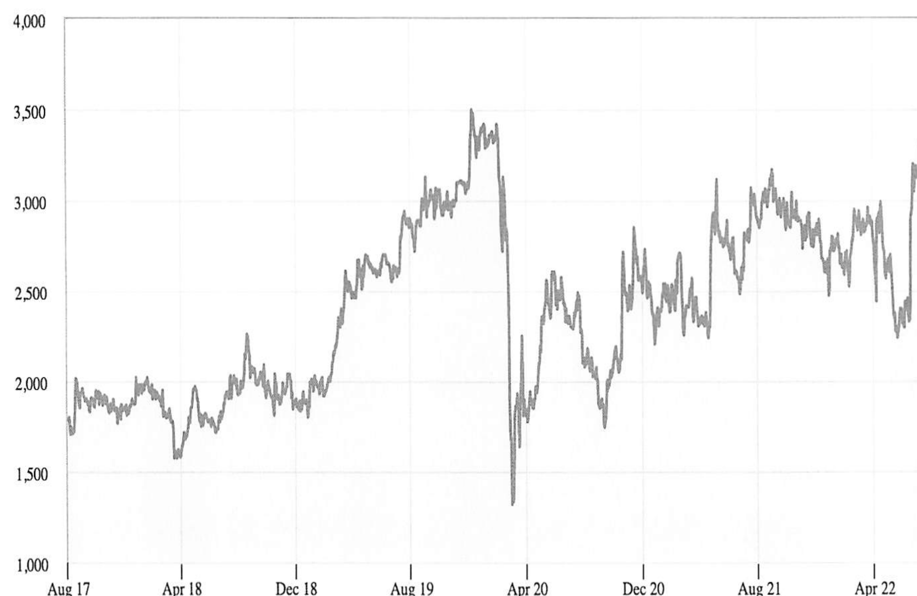
4Imprint was founded by Dick Nelson as Nelson Marketing in Logansport, Indiana, in 1985 and 11 years later was acquired by Bemrose, owner of several diverse specialist print and packaging operations including Letts, the famous diaries and calendars business.

Following a shareholder rebellion in 2003, when takeover talks with private equity group, Hanover Investments, broke down, the original team walked the plank and a new management was brought in. They viewed the print & packaging side as too capital intensive and the diaries at risk of obsolescence due to the shift towards electronic organisers (later themselves eaten by the free diary Apps in smartphones).

As a result, these businesses were sold off, with the group concentrating on its promotional products business. At that stage 4Imprint was left with two divisions in the UK and USA but the former, trading as Brand Addition – which is now back on AIM as the wheels turn full circle- was over-dependant on just three customers and its subsequent disposal not only eliminated a low quality business but also allowed 4Imprint to plug a large hole in its pension deficit.

Eps up 480% between FY'11-'19

While it's retained a small marketing operation in the UK based in Manchester, that contributed less than 2% group sales in FY'21, the other 98% comes from the USA-based promotional products business. Under the leadership of divisional USA head Kevin Lyons-Tarr, who was later promoted to CEO, the company has gone from strength to strength. Back in 2011 it had sales of US$192.4m, pretax profit of US$9.8m and eps of 26.6 cents but fast forwarding to 2019, the last undisturbed year before the Pandemic, that had increased to US$861m, US$54.7m and 154.4 cents.



"Bust a US$1 billion" hit a year early

A further measure of the amazing momentum running through the business is that early in 2018 it had set a target to increase revenue from US$627m the previous year to US$ 1billion by 2022 but following those three upgrades, analysts now expect sales to increase to US$1,041m this year, rising to US$1,144m and US$1,256m. Meanwhile pretax profit is expected to be US$83.7m, rising to US$92.5m and then US$104.2m in FY'24 for eps of 225.9 cents (186.7p), 244.8 cents (203p) and then 275.2 cents (227.7p).

Wide range of products

Based in Oshkosh, Wisconsin, 4Imprint supplies tens of thousands of promotional products such as t-shirts, fleeces, sweaters, pens, key rings and other office accessories as well as bags, badges, mugs and watches. In recent years it's added conference bags, lap top sleeves, parasols, gazebos, phone stands, wireless headphones, Bluetooth speakers, women's hoodies, sports towels, vacuum bottles and flags. It's also developed own brands including Crossland for outdoor apparel such as fleece jackets, backpacks and coolers; refresh (metal drinkware); and TaskRight, for everyday stationery such as notepads and sticky pads.

Apparel fastest growing category

CEO Kevin Lyons Tarr, who I met with over the month, says Apparel is the fastest growing category, having been under-indexed for years and now accounts for well north of 20% of sales. The other significant categories are drinkware, writing tools and bags.

These products will typically have the name and / or logo of the client emblazoned onto them and are purchased by a wide range of individuals within all types of businesses and organizations, typically with at least 25 members of staff. These products are used as part of a client's sales and marketing campaign, such as at a trade show or promotional giveaway for a welcome kit; to promote health & safety initiatives; and as a thank you for employee / volunteer recognition schemes.

Still just 5% market share

Customers are defined as the individual placing the order, rather than the business or organization for which the individual works. To give you an idea of the quantum of its growth back in FY'11 it achieved 450,000 total orders, but fast forward to FY'21 and that had increased to 1,429,000

orders, representing 90% of former peak levels in '19. This has propelled the group to its position as the market leader but there's still bags of room to grow with its market share just 5% of the estimated US$20 billion US / Canadian market for promotional products. The market itself is highly fragmented and out of the estimated 26,000 other distributors, fewer than 1,000 have annual revenues of more than US$2.5m.

Industry grew 46% in 12 years

But this is not just a story about taking share from rivals, because the promotional products market itself has enjoyed significant growth as companies view it as providing better "bang for their buck" than other forms of media like traditional radio and television advertising. Figures from the Advertising Specialty Institute (ASI) show that North American sales grew from US$15.9 billion in FY'09 to US$25.8 bn in FY'19 and after dropping to US$20.7 bn when Covid-29 hit the following year, they recovered to US$23.2bn in FY'21, up around 46% over 12 years. It goes without saying that 4 Imprint has substantially outperformed this.

Repeat customers: 70% of total

However, the real power under the hood is 4Imprint's canny marketing strategy. With the business long established for nearly 40 years it has built up a large and valuable database of customers. In order to generate new business these were historically mailed paper catalogues through the post and by emails, supplementary mailings and telephone calls. Save for exceptionally difficult trading conditions, 4Imprint typically makes a modest profit on recruiting new customers after covering the costs of off-the-page or internet advertising but the real gains are made from repeat orders, which are higher margin because the cost of marketing has already been absorbed.

Thanks to canny techniques such as "blue box" targeted sample mailings, which "deliver the showroom to the customer," repeat orders in FY'21 accounted for a massive 70% of total orders of 1,429,000.

Soaring revenue / marketing dollar

However even that doesn't tell the whole story. Back in early 2018 it tweaked its marketing strategy with the aim of increasing its brand awareness and adding a level of agility in order to "flex" marketing investment to suit the changing economic climate. That involved a reduction in direct mail investment (reducing print, catalogues, postage costs) and an increase in TV and online advertising spend. As Lyons-Tarr says, the TV and internet advertising is simply about helping explain what the company does and what it stands for and getting that message to the widest possible audience.

At the same time management introduced a new KPI metric – revenues / marketing US$ - to track its effectiveness. With management better able to tailor investment according to market demand, this key metric improved from 5.58 in FY'19 to 6.17 in '21 but this year has been more dramatic still, climbing to a record 8.0. That in turn has driven a 14% increase in both order counts and average order values in H1 2022 versus H1 '19 (i.e. pre-Pandemic).

With gross margins remaining steady the benefits of operational leverage (i.e. higher sales on a relatively fixed cost base) are expected to drive operating margins up from 3.9% to 7.5% this year.

High returns on capital

The icing on the cake for shareholders is that 4Imprint has a proverbial licence to generate free cash. It doesn't manufacture any of its products itself and is therefore not required to fund hefty capital expenditure on expensive equipment. Instead, it outsources to a network of suppliers, who hold the "blank" inventory and after receiving the order and accompanying art work (i.e. including customer branding) from 4Imprint will print it and send it on to the customer. It's a "just in time" model and 4Imprint holds very little inventory.

With only modest capital required to run the business, its average return on capital employed between FY'17-'19 was 82-86% and while that dipped to 41% last year it's expected to recover quickly.

One issue that dogged it last year was rising shipping / freight costs and supply chain disruption but these have started to recede. There is also a short-term risk of softer demand in the US as interest rates rise further but that ability to flex marketing spend will smooth any bumps.

Another special dividend likely

With the company having largely resolved its long standing pension deficit, CFO David Seekings notes that annual payments of just US$4m are required to set up a scheduled buy-out in FY'24 after which point it will be "free and clear," as the Americans say. As a result, net cash, currently a healthy US$66m, is forecast to reach US$117m by FY'24, which raises the prospect of a special dividend alongside an expected regular one of 127 cents (105p) this year (yield: 2.8%).

Its usual H1/H2 pretax profit split is 36/64 but Barclays notes the latest H1 22 pretax profit of US$44 is 53% of full year forecasts, implying more hefty upgrades in store should its run rate continue. Based on that, the soon to be prospective PE of 18.3 and then 16.4 is too low. *I am a buyer.*

Updates, upgrades and downgrades

Begbies Traynor (BEG) 146.5p
Sector: AIM, Brokerage Services

Corporate insolvency specialist Begbies Traynor is just the type of business to benefit from the ongoing consumer spending squeeze and final results for the year ended April 2022 did not disappoint with revenue of £110m, up 31% year on year and 3% ahead of forecast. Pretax profit (+54% to £17.8m) ad eps, which rose 32% to 8.8p, beat forecasts by a slightly wider margin.

The larger business recovery and advisory side increased profit 43% to £21m on sales ahead by 36% to £81.4m, helped by the acquisitions last year of CVR Global and David Rubin & Partners. Market share has also risen from 12% to 14%. Broker Canaccord notes a 50% rise in corporate insolvency numbers to 16,648, the bulk of which are smaller scale liquidations, rather than the complex higher value administrations but expects that to switch to the latter going forward, which would prove the greater money spinner for Begbies. Management reports that the order book of committed insolvency revenue has increased 4% to £29.5m.

Within Advisory, the newly acquired finance broker, MAF Finance, has traded well and grown profits in line with earnout targets having arranged lending worth £330m versus £150m in the prior year.

In Property Advisory profits rose 25% to £4.8m on sales up 19% to £28.6m (organic growth 10%). Activity levels were reportedly higher than lockdown with growth driven by an enlarged team working on more mandates with higher average fees.

Most recently, Begbies has acquired Antra Capital, a London-based property finance brokerage for an initial £4.5m, which will strengthen its strong performing MAF finance brokerage acquisition.

Canaccord has upgraded FY'23 eps by 4% to 9.9p in FY'23 and by 5% in '24 to 10.0p. Its price target jumps from 138p to 180p. *Highlighted at 135p last September, the broadly unchanged price doesn't justify strong prospects. I am a buyer.*

At the time of going to press, the editorial team held the following shares mentioned in this issue: Reach, Me Group, T Clarke

Updates, upgrades and downgrades

ME Group (MEGP) 104p
Sector: Leisure Goods

Shares in ME Group (the new name for Photo-Me) jumped after it announced a special dividend of 6.5p, which accompanied strong interims with revenue up 22% to £115.3m and pretax profit increasing 24% to £16m.

Results were driven by returning demand for photo ID services (ahead of expectations) with revenues up 27% to £66.9m while the expansion of its *Revolution* laundry machines continues apace (sales +37% to £25.3m).

ME also upgraded its full year guidance for pretax profit of £47m-£50m. Canaccord forecasts eps of 10.0p.

Highlighted as an idea in May '21 at 62p, the shares have gained 78% including the special dividend. I am holding for more.

T Clarke (CTO) 162p
Sector: Construction

The transformation of electrical contractor, T Clarke into a genuine growth stock goes on. Revenues for the half year to end June exceeded £200m for the first time, representing 49% growth.

London grew sales from £73m to £125m with operating profit soaring from £1m to £5.8m thanks to major data centre projects while engineering services saw high profile work on commercial and hotel developments. Impressively, operating margins grew from 1.4% to 4.6% with broker Cenkos noting Clarke has a higher proportion of directly employed labour than any of its peers and is only subject to one pay settlement per year, which avoids the risk of cost spikes when using third party contractors.

UK South posted profits of £1.2m with operating margins of 2.8% dipping from 3.7% but are expected to recover in H2. A new office in Oxford went live. Its Northern division produced profit of £1.1m with margins of 2.7% expected to be maintained in H2.

Meanwhile, T Clarke has increased its revolving credit facility by £10m to £25m (expiring 2026) and extended its bonding facilities to £65m of which £28m is in use, now considered a key differentiator in the bidding process.

With the order book at a record £586m (+10% on December '21) and a bid pipeline in excess of £1 billion, Cenkos has upgraded turnover forecasts from £410m to £450m but eps only increases 1.5% to 21.4p, rising to 24.2p in FY'23, due to conservative cost assumptions. The shares, which have performed resiliently in a tough market, are cheap on a prospective PE of 7.6 and then 6.7. *I am a buyer.*

Crest Nicholson (CRST) 278p
Sector: House Leisure & pers goods

A welcome forecast upgrade for housebuilder, Crest Nicholson, which accompanied its interim results by upgrading its full year guidance to around £135-£140m. This reflects continued strength of demand and an excellent order book, covering 96% of expected volumes.

Revenues went up 12% to £364.3m, with completions increasing by 7.8% at 1,096 units and sales per outlet week climbing from 0.69 to 0.72. However, the real surprise was the increase in operating profit margin from 12.3% in H1 '21 to 15.0%, with input cost inflation well managed, driving a 45% increase in operating profit to £52.5m. Crest has (and continues to) exit several challenging legacy projects, which together with a new house type, which will be in 75% private houses in FY'22 and new land purchases at attractive forecast margins, has driven up profitability. Return on capital employed jumped from 10.5% to 18.3%.

Liberum, which has upgraded eps forecasts by 6% to 41.2p, remains convinced that macro-challenges will only slow the cycle not end it and therefore sees significant upside across the sector. Its target price is 390p. *Trading on a lowly prospective PE of just 6.7 and forecast dividend yield of 5.9% (16.5p) and backed by forecast FY'22 net cash of £180m, I am a buyer.*

Coats Group (COA) 65.5p
Sector: General Industrials

Less than two months after I made Coats a main write-up its half year results came in ahead of expectations. Earnings before interest and tax rose 35% to US$125m, well ahead of Peel Hunt's US$115m forecast, driven by strong volume growth and pricing. With US$65m cost inflation offset by US$57m price increases, cost reductions and favourable mix changes, EBIT margin improved 1.8% to 15.6% and there's more to come with US$50m savings expected from strategic projects.

Apparel & Footwear, its threads and zips side, was the main source of the 'beat,' increasing profit 30% to US$107m (EBIT margin from 15.5% to 18.2%) on sales up 11% to US$587m.

In Performance Materials (personal protection, composites, performance threads), profit rose 41% to US$18m on sales that increased 6.3% to US$214m, largely thanks to higher spend from existing customers and new wins, albeit US labour availability and wage inflation is still to be resolved.

Interestingly, Coats has also announced the acquisition of Texon, which supplies high-performance sustainable materials, including heel counters, toe puffs and insoles to the fast growing premium athleisure footwear market. The deal cost US$237m, which is expected to be eps enhancing in its first full year.

Peel Hunt has upgraded and now expects eps of 8.1 cents this year, rising to 10.1 (8.3p) and then 11.7 (9.7p) in FY'24, dropping the soon to be prospective PE to 7.9 and then 6.8. *I am a buyer.*

Hill & Smith (HILS) 1232p
Sector: Industrial Engineering

As I flagged in my write-up the group is improving the quality of earnings by selling off its under-performing businesses. Latest to go is its loss-making Swedish rental business and US road traffic control portfolio, the latter for c. £61.5m, which will enhance group operating margin while the funds will be used to reduce debt.

The group also issued solid half year results with sales ahead 12% to £350m, while operating profit rose 16% to £43.6m. Eps increased 13% to 38.7p. The group reported a £41.5m working capital outflow, reflecting investment in inventory and rising raw material costs.

Galvanising services grew revenues 17%, while operating margins rose 0.9% to 25.3% as costs were passed on to customers. Engineered Solutions (formerly utilities) also performed strongly, with sales up 21%. However, margin fell by 0.7% to 10.3% due to less favourable US composites business. Roads & security had some under-performance but management expects improvement in H2.

Numis has upgraded eps 4% to 85.1p thanks to foreign exchange tail-winds and say there's good visibility on increased UK roads activity, while there's increased expectation that the "Biden boom" in US infrastructure spend will materialize in 2023. *Two directors have recently bought shares worth almost £70,000. I too am a buyer.*

Ten Entertainment (TEG) 222p
Sector: Tourism & Leisure

Strong trading momentum has continued at ten-pin bowling operator, TEN, whose first half update stated that trading had been so strong that it would now beat full year expectations. Impressively, customer footfall is 43% higher than FY'19 levels and drove 46% growth in like-for-like sales, more than enough to outpace inflationary pressures with entertainment prices held at 2019 levels.

Liberum says the customer database has also grown by 89%, driving an increase in the frequency of visits while online ordering has boosted ancillary sales with food & beverage up 41%.

A centre was acquired in May 2022 and a brand new centre in Walsall will open in Q3. Three further new centres have been agreed and expected to open over the new 12 months.

With food and beverage and consumables just 11% of costs, it's better positioned than rivals to manage cost inflation.

Liberum has upgraded pretax profit by 17% for both FY'22 and '23 to £23m and £28.1m for eps of 25.4p and 31.1p, dropping the prospective PE to 8.7 and then just 7.1. Its target price is 370p. *I am a buyer.*

Updates, upgrades and downgrades

Reach (RCH) 94p
Sector: Media

Reach again showed its mettle in tough advertising conditions with first half revenues declining 2% to £297.4m. However, a 7% rise in operating costs - chiefly a 54% hike in newsprint to £38.8m alone – meant operating margins declined almost 7% to 15.9%, leading to a one third decline in operating profit to £47.2m and eps to 12p.

Digital revenue growth slowed to 5.4% year on year in H1, with Q2 flat, driven by a significant proportion of "brand unsafe" content due to the Ukraine war and a deterioration in wider market yields as weaker macro conditions caused advertisers to cut back. However, this was partially offset by strong performance in its data driven *Plus* products, with yields up to 10x OMP, and which now represents over 30% digital revenue up from less than 20%. Encouragingly, digital strategy continues to progress with registered users now 11.5m (from 5m in FY'20), increasing the quality of data points for advertisers. Aggregate page views rose 8%, audience numbers increased 2% while a high proportion (c 5m) were active in the last 28 days. Critically, loyal users grew 17% and registered page views rose 103%.

In Print, circulation sales fell 5% to £151.8m, with a slight improvement in Q2, as higher than historic cover price increases were introduced. Print advertising declined 10% to £45.3m, against strong prior year comps when Government Covid-19 advertising was strong.

Encouragingly, the pension deficit reduced 41% to £91m driven by a rise in the actuarial discount rate from 2% to 3.7% after years of decline. Broker, Singer, thinks this could significantly reduce cash contributions (currently c. £57m p.a.) with the deficit forecast to fully close within 18-24 months, which alone could drive a large re-rating.

Management have accelerated efficiency programs and mitigated newsprint cost inflation including through reduced pagination and print runs, while entering new longer term (18 month) contracts with suppliers to hedge against further spikes.

As a result the downgrades are relatively modest with Singer forecasting eps of 28.6p, while Panmure expects 29.7p (from 32.5p). *The prospective PE of c.3 and dividend yield of nearly 9% offer outstanding value. I'm surprised the shares are back here, but clearly a bargain if taking a 12-18 month view. I am a buyer.*

Somero (SOM) 425p
Sector: AIM, Engineering

Somero has announced that helped by strong order backlogs full year results will be in line with expectations and it expects to make revenues of US$138.8m, EBITDA of US$47.7m, and year-end cash of approximately US$39.9m, matching last year's elevated levels. New products contributed meaningfully to H1 sales and the company is making good progress identifying opportunities to penetrate untapped market segments, while also developing new solutions for customers. It's also on track to complete its expansion at Houghton, Michigan by the end of Q3.

While rising interest rates in the US add some uncertainty to end market demand the shares look way over-sold on a prospective PE of 8.1 (eps forecast: 62.8 cents (52.6p). *I am a buyer.*

Forterra (FORT) 295.5p
Sector: Construction

Brick maker Forterra's interim results were slightly ahead of expectations with revenues and EBITDA both ahead 24% to £223m and £46m, respectively. Eps rose 45% to 13.5p.

There's no sign of a let up in demand with brick and block prices rising 30% to prevent rising costs from eating into profitability. EBITDA margins rose 0.2% to 20.7%.

Total capex was £21.3m of which £15.8m related to the new Desford factory, which is on schedule for commissioning late this year. The Wilnecote factory is to be shut in September for redevelopment and restarted in Q4 '23 while a new brick slips line is due to begin Q4 '23.

Forterra has bought back £20.6m shares with a total of £40m expected by the year end.

Highlighted at 277.5p in April '21, the shares have performed well and trade on a prospective PE of 11.4, based on an eps forecast of 26p. I am continuing to hold.

Brickability (BRCK) 81p
Sector: AIM, Construction & Materials

Brick factor Brickability's final results were slightly ahead with pretax profit of £34.7m (Cenkos forecast: £34.1m) and eps 10.1p (9.6p), representing year on year growth of 131% and 81%. That reflected favourable inflationary trading conditions and acquisitions, the most transformative being Taylor Maxwell, although organic growth was seen across all divisions.

Bricks & Building Materials grew sales 32% to £462m including like-for-like growth of 32%, helped by acquisitions and the "exceptional" profits simply by holding lumber stocks that have soared in price. The reduction in EBITDA margin from 8.1% to 7.2% reflects the mix effect from lower margin Taylor Maxwell.

In Roofing Services underlying revenues grew 32% but EBITDA margin sunk from 21% to 14.2% due to tail of legacy contracts. Finally, heating, plumbing & joinery grew sales 31% led by Towelrads (EBITDA margin 19.6%).

Cenkos has upgraded eps forecasts by 4% to 10.3p for FY'23. The prospective PE of just 7.9 has caught the eye of a director, who just purchased 123,500 at 81p. *I am a buyer.*

Elementis (ELM) 116p
Sector: Industrial Chemicals

The shares jumped after Elementis reported H1 and said full year results will now be near the top end of expectations. Sales rose 9% to US$478m, while operating profit increased 21% to US$66m (16% above consensus). Eps rose 29% to 7.1 cents.

Coatings, formerly Speciality Products, whose additives control and change a liquid's viscosity and thickness, increased revenue 9% to US$209m. Adjusted operating profit of US$44m was significantly up on the prior year (US$33m) thanks to new business momentum, particularly North America, and successful pricing actions partially offsetting China volume weakness and normalisation of European decorative demand. Adjusted operating profit margins were 20.9%, up from 16.7% reflective of improved product portfolio, new business wins and pricing actions, offsetting accelerating input cost inflation.

Personal Care (products which improve the feel of creams and lotions on the skin) increased revenue up 23% to US$106m. Operating profit rose 42% to US$26m, with operating margin of 24.5%, up from 21.6%. This was driven by improved category demand as COVID-19 restrictions ease, pricing actions and continued new business in Asia.

Talc, which supplies additives to the automotive sector, reduced profit from US$8m to US$3m reflecting weak European vehicle demand.

An update on the strategic review of its non-core Chromium business is expected at the year-end.

Broker, UBS, which forecasts operating profit of US$112m (eps: 12 cents) notes the top of the range of expectations would imply US$125m, so I would expect useful outperformance in the shares.

Restaurant Group (RTN) 50p
Sector: Travel & Leisure

Restaurant Group has announced the acquisition of Barburrito, an award winning Mexican style fast-casual restaurant chain, focused on fast, fresh, affordable (average spend c. £10) and healthy Mexican food, which adds another useful leg to growth. The deal cost £7m and Barburrito's 16 existing sites are expected to make EBITDA and pretax profit of c. £1.6m and £0.8m, respectively, over the next 12 months implying an exit run rate of just 4.4x EBITDA.

In a sign of confidence Restaurant Group has also chosen to repay £44m of term loan facilities, reducing total available debt to £361m but it retains un-used headroom in excess of £190m against these facilities. It's also purchased interest rate caps on £225m of debt to protect against rate rises.

Following heavy buying by directors, I am a buyer once again.

TMI Trader Portfolio 2

When a flock of geese destroyed both engines shortly after taking off from New York's LaGuardia airport, Captain Chesley Sullenburger was hailed for landing the aircraft safely onto the surface of the Hudson river. But at the moment he realized both engines had lost power Sullenburger's first thoughts were, "This can't be happening…This doesn't happen to me." This raw insight to human reaction when the unthinkable happens has been dubbed "our inner chimp;" when under threat we behave like our original ancestor, the one who behaved like any other animal in the jungle and poor decisions get made instinctively. As part of their control course, pilots perfect their skills in remaining calm and in much the same way, investors must now put the chimp back in the box and think rationally. The best investors are able to cut out the noise and often outperform in the long run through inaction (i.e. buy and hold) rather than a kneejerk sell. This is probably where markets are right now, with the TMI Trader Portfolio 2 having swung from a gain of over 15% last August to a loss of 2% currently, broadly tracking the small cap and AIM indices, which have fallen 14% and 29%, respectively from previous peaks.

Reach finds itself in the microcosm, with the "black swans" of the Pandemic and Ukraine causing short-term havoc, through a c. 60% spike in printing costs. The chimp has driven down the PE from 11.7 to around 3 even though: net cash is forecast to remain unchanged at £66m; the dividend has been increased (yield: c.9%); the pension deficit could be eliminated in two years rather than five; eps has only been clipped c. 10%; and most significantly, data-led Plus products, which can yield 10x open market rates, now make up over 30% of digital revenues.

Mindful of the lurking chimp, for this issue I have gone with two high quality businesses I know well. At a time when commercial rents have fallen unimaginable levels, cash-rich casual dining operator Loungers (page 1) plans to accelerate new openings from 24 to 32 as it targets growing its estate from 200 to 500 outlets. My other write-up, promotional products group, 4Imprint, is a former Trader Portfolio multi-bagger, which has seen two huge upgrades to forecasts since May.

PERFORMANCE TABLE

	Current Value	Change on One Month	Change Since Start
TMI Trader Portfolio 2		+6.6%	-2.0%
FTSE-100	7466	+4.2%	+26.5%
FTSE-All Share	4131	+4.7%	+24.3%

TMI TRADER PORTFOLIO 1

Starting Capital (25.3.02):	£100,000
Termination Value (11.12.20):	£618,710
Portfolio gain:	+518.7%
FTSE-100 gain in period:	+24.7%
FTSE-All Share gain:	+44.6%

EPIC	Quantity	Description	Date Bought	Acquisition price (p)	Book Cost (£)	Current Price (p)	Current Value (£)	Change (%)
DX.	45,000	DX Group	16/11/20	19.5	8,820	30	13,500	+53
DLAR	5,000	De La Rue	16/11/20	168	8,487	92	4,600	-46
CAML	4,250	Central Asia Metals	21/12/20	224	9,565	248.5	10,561	+10
SOM	2,500	Somero +	12/2/21	339	8,520	425	10,625	+25
RCH	3,600	Reach	21/6/21	263	9,560	94	3,384	-65
VP.	1,000	VP	19/7/21	950	9,593	872	8,720	-9
ESNT	3,000	Essentra	22/11/21	314	9,465	246.5	7,395	-22
SUR	12,000	Sureserve	10/3/22	79	9,525	86.5	10,380	+9
SRC	11,000	SigmaRoc	16/3/22	83	9,175	55	6,050	-34
BAB	2,800	Babcock	14/4/22	323	9,044	340	9,520	+4
HAT	2,600	H&T	7/7/22	361	9,431	439	11,414	+21

Stock value	£96,149
Cash	£1,835
Total fund value	£97,984

* Part profits taken + Acquisition price adjusted for two special dividends

Starting capital £100,000 (December 2020)

Current holdings in the portfolio are valued at mid-prices and include dealing commission

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• *Unless otherwise stated, share prices quoted are correct as at 11/8/22*

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ISSN 1476-895X