In its twenty-fifth year
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TMI

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

The Momentum Investor

S T O C K M A R K E T N E W S L E T T E R

Authoritative Independent Monthly Share Selections using Technical & Fundamental Analysis

This Issue

Hunting — Buy
Explosive demand and a soon-to-be prospective PE of 9.0

Cake Box — Buy
Upgraded site target not reflected in lowly prospective PE of 11.2 and then 9.7

Energean — Buy
War fears leave shares on incredible soon-to-be prospective PE of 2.7

Hollywood Bowl — Buy
Trading ahead of expectations; analysts upgrade

Volution
Shares rally after forecasts nudged higher

Telecom Plus
Refreshed deal with E.ON provides opportunities

Hostelworld
Blow-out 43% bookings growth drives upgrades

Loungers
Like-for-like sales accelerate to almost 10%

- - -

FTSE-100: 7418
FTSE-All Share: 4028
Small-Cap: 5901

Next issue on Saturday 16 December

Always remember the risks in buying shares. With small companies there is an above average degree of risk compared to buying blue chips. Please be aware that we have not assessed the suitability of any of these investments for you. The newsletter simply states a personal view and diarises the editor's investment decisions. You should therefore consider this publication as information only and not as a recommendation to engage in investment activity. Please speak to your stockbroker or other qualified individual to ascertain whether any of these companies mentioned would form useful additions to your own portfolios. Past performance is no indication of future success.

Hunting

Sector: Fossil Fuels. Share Price: 297p Epic Code: HTG

Key Data

Address:	30 Panton Street, 5th Floor, London,SW1Y 4AJ
Telephone:	020 7321 0123
Shares in issue:	164.9m
Market Capitalisation:	£489.8
Next Results:	Finals: March

The febrile situation in the Middle East has forced analysts to reappraise their forecasts for oil prices and Bloomberg Economics has broken cover to predict that "if Israel ends up in direct conflict with Iran, prices could hit US$150 / barrel, over 70% above today's levels." This is because around 20-30% of global supply passes through the strait of Hormuz, the world's most strategically important passage for international trade, which runs alongside the coast of Iran (as well as the UAE and Oman) and is just 21 miles wide at its narrowest point.

Once described by a former Iranian Prime minister as "our jugular vein," the Strait has been claimed territorially several times by Iran, against international maritime law, and to borrow an infamous quote from the late US secretary of Defence, Donald Rumsfeld, it's a "known unknown" that could unleash a global crisis. One company in the energy sector that is already on a tear is Hunting, which manufactures high-value precision tools and components used in oil & gas wells. The exciting thing here is that even without the benefit of an oil price spike, Hunting is trading particularly well and forecasts have been raised twice in a year. Zeus expects EBITDA to increase from US$52m in 2022 to US$96.8m this year and then US$124.8m in '24 for eps of 25.7 cents (21.2p) and 38.2 cents (31.6p). A more bullish broker, Investec, expects US$99.5m and US$130.6m, and has also introduced a FY'25 forecast of US$163m for eps of 25.7 cents (21.2p), 39.8 cents (32.9p) and 53.9 cents (44.5p).

Underinvestment drives demand

The bullish forecasts reflect two factors. First, Hunting says the market environment is the best since oil was last at US$100 / barrel in 2014. Since that peak and the subsequent price collapses (initially due to a price war between Saudi Arabia and the US fracking upstarts, and lately because of the pandemic) the oil & gas majors have retrenched their upstream capital spend on exploration & production from US$1 trillion to less than US$400 billion. But Hunting says that with oil demand expected to increase from c. 102 million barrels per day (mmbopd) to c. 108 mmbopd by 2030, these cuts will lead to a 22 mmbopd "supply gap" opening up as key fields deplete. Consequently, capex on upstream spend in the industry has rebounded to around US$550 bn to at least the end of the decade.

Moving up value chain

The other reason for the buoyant forecasts is that Hunting is diversifying away from its legacy activity (perforating guns for fracking) where earnings visibility is at best four months, contracts are small and business is dependent on the number of active oil rigs, and has been busy expanding into less commoditised markets where margins are higher and contracts are bigger and of longer duration (up to 18 months). It was no coincidence that Hunting's CEO remarkably stated that the outlook for earnings out to 2025 "is so bright you'll need sunglasses"...

Order book surges over 50%

….And he's backed it up with three super-league contract wins: US$86m for an offshore project in China for CNOOC announced in August '22; US$91m for Cairn Oil & Gas in Rajasthan, India in May; and a US$59m order in South America last month. That's led to a surge

in Hunting's order book from US$326m as at June 2022 to US$560m. Excitingly, it's also bidding for tenders worth another US$1 billion, roughly double a year ago according to CFO Bruce Ferguson, who I met with over the month. Ferguson says its success rate is around one in two and of that US$1 billion there's two Middle East tenders, each for US$50m-US$100m, which could be announced before the year-end.

US$2 billion sales by 2030

Thanks to these wins at the very least Hunting should achieve forecasts, which drop the soon-to-be prospective PE to 9.0 and then just 6.7 and for a company about to be free of net debt, the shares are very cheap. But as they say, it's Go Big or Go Home and in an impressive Capital Markets Day presentation, management introduced ambitious new targets.

From a base of US$726m sales and EBITDA margins of 7% last year, they are aiming for US$1,300 million and 15% margins by FY'25. The latter would imply EBITDA of US$195m, around 20% above Investec's numbers. By 2030 they expect sales to hit a massive US$2,000m with a further rise in margins. Guidance is also for double digit dividend rises (FY'23 forecast 11 cents, yield 3.1%).

While the majority of sales growth will be organic, including deep water drilling, geothermal heat extraction and carbon capture utilisation and storage (CCUS) management have also telegraphed increased M&A activity, mostly debt financed (Hunting has a US$150m facility) to ensure shareholders receive bang for their buck.

History

Hunting can trace its roots back to 1874 when it was founded as a shipping business by veterinary surgeon Charles Hunting. Post World War II it became involved in air transportation, defence and the transportation and marketing of crude oil in Canada (Gibson). These have been sold and the proceeds have financed expansion into its sole remaining activity, Hunting Energy Services. The landmark acquisition to provide critical mass was Titan, a provider of perforating guns used in fracking, a controversial extraction technique in which millions of gallons of fluids are pumped through rock to release trapped gas.

At present, Hunting operates from 30 sites around the world including the US (multiple locations), Singapore, Indonesia, India, Mexico, Saudi Arabia and Holland while it can boast over 500 patents and trademarks across key technologies and geographies.

Forecasts by product

As I mentioned earlier, Hunting has since diversified into other areas and based on its own forecasts, its projected revenue for 2023 by product line is as follows:

- OCTG: 39%;
- Perforating Systems (Titan): 30%;
- Advanced Manufacturing: 10%;
- Subsea: 10%;
- Oher Manufacturing 11%.

OCTG

People often bemoan the lack of "lower hanging fruit" to describe the difficulty in finding those large oil & gas discoveries of yester-year and back in the late 1940s the average prospector drilled well shafts down to maybe 1,000 meters below the surface but with big finds harder to come by, operators nowadays must drill far deeper to around 3,000 metres. At that depth the environment is harsh and the drilling equipment must be able to withstand crushing pressure and torque without breaking down as profits can be quickly eaten up by such delays. This is where Hunting comes in.

Its largest product line by turnover is OCTG (39% forecast FY'23 sales), short for Oil Country Tubular Goods, which are durable steel pipes that go down the well shaft (bore holes). These include drill pipes (a heavy, seamless tube that rotates the drill bit and circulates drilling fluid); steel casing pipes (stabilising the well by lining the well shaft with cement to hold in place) and tubing pipes (which go inside the casing and help transport the oil up to the surface and processing facilities).

Around 80% OCTG sales are derived from its

Easyjet (EZJ), 391p

There are signs of life in low cost air travel with **Wizz Air**, 1827p, seeing a 19.4% jump in passenger numbers in October, while **Ryanair**, €16.15 (listed on Euronext) saw an 11% rise in passengers and a massive 59% increase in profit for the half-year to September, even wowing with a maiden dividend. Another doing well is Easyjet, which expects to show a record second half (profit: £850-£870m) driven by 7% passenger growth and a 15% rise in revenue per passenger. Unchanged FY23 guidance of £440-£460m would surely have been higher but for the large winter losses, a hangover from the pandemic. Nevertheless the outlook is rosier with Easyjet announcing a new target to exceed £1bn pretax profit in the "medium-term."

Easyjet is second only to market leader Ryanair in terms of passenger traffic. Its crown jewels lie within its lucrative network of take-off-and-landing slots both within the UK at airports such as Gatwick, Luton and Stansted and overseas, with number one or two positions in Nice, Milan Malpensa, Naples, Venice, Geneva, Amsterdam, Paris Charles de Gaulle and Lisbon. Many of these locations are "slot constrained" where demand for runway and gate access exceeds airport capacity and airlines only lose them if they don't use them. This keeps out competition.

Easyjet's rising profitability will be helped by an efficiency drive with it retiring older planes, such as the A319 and replacing it with the larger and more fuel efficient A320 neos (15% of total), which have 186 seats versus 150. For this year (starting 1st October) it expects 10% aircraft utilisation gains and productivity benefits for the pilots and crew.

Easyjet Holidays, which up-sells holiday packages to existing customers, is now remarkably expected to achieve £120m pretax profit, 50% more than previously expected after doubling market share to 5%.

Consensus eps forecasts are for 47p rising to 54p in FY'24 dropping the prospective PE to just 7.2. *I am a buyer.*

Energean (ENOG), 897p

A famous stock market adage coined in 1810 by financier Nathan Rothschild is to "buy on the sound of cannons and sell on the sound of trumpets," the idea being to invest when a war breaks out and sell at its end. This strategy worked like a dream back in 2003 when the US invaded Iraq to stop Saddam Hussein's infamously non-existent weapons of mass destruction but clearly didn't work at the start of the Russian invasion of Ukraine.

Now here we are again, this time with Israel preparing a massive ground war in Gaza following those earlier atrocities, but the big difference is that shares are already cheaper. Take Energean, for example, an energy producer that owns oil & gas interests in Egypt, Italy and Israel. Its shares have almost halved from over £15 because of those war fears. Although not without risk, and to be fair it is near the conflict zone (with a nearby field having been shut down as a precaution), the prospective PE for FY24 is just 2.7 and dividend yield is 16% (!); You-pays-your-money-you-takes-your-choice, as they say.

The activities in Israel include its flagship asset, the *Karish* field, which achieved first gas in Q4 22. In spite of a slight technical stumble in the first half of 2023 alongside fears an escalating war between Israel and Hamas could force an extended shut-down (although nothing has been announced to date), it expects to increase production to 120-130,000 barrels oil equivalent per day (boepd) this year and to 200,000 by the end of 2024. That would equate to a near six-fold production increase in just three years! According to Peel Hunt this would increase turnover by 240% to US$2.5 billion by FY'24 and EBITDA almost five-fold to US$1.8bn from a base of just US$0.74bn and US$0.38bn, respectively, in FY22.

Founded by former banker and petroleum engineer Matthios Rigas, the company started out buying some mature oil production assets in Greece before the acquisition of several natural gas offshore fields, known as Karish and *Tanin* at the equivalent of just US$0.4 / barrel. It was the deal of a life time and a recent run of five-out-of-five discoveries on the nearby *Katlan* licence (formerly Olympus) means proven and probable reserves are now expected to have risen from nearly 1 billion barrels oil equivalent in FY21 to over 1.4 billion.

Energean also enjoyed a stroke of luck because Israel's energy infrastructure had been dramatically upgraded following material discoveries over the past decade including the giant *Tamar* and *Leviathan* finds and there are gas export pipelines to Egypt, Hadera in Israel and Jordan as well as gas fired power plants. That meant Energean's only significant up-front cost was to build a floating production and storage offtake (FPSO) vessel, which produces, processes and stores hydrocarbons before offloading them onto a tanker or pipeline. The FPSO cost US$1.7bn and increased net debt to US$2.7 billion as at H1 23. The debt has a six year average maturity and is mostly fixed at an average rate of 5.4%. But with Karish now producing a steady 6 billion cubic metres (bcm) per year and having locked in lucrative long-term gas contracts stretching well into the 2030s, net debt / EBITDA is expected to fall sharply from almost 4x to just 1.5x by FY'24.

In order to achieve its growth targets Energean must execute the start-up of its new field, *Karish North*, in Q4 23 and an expansion of its FPSO capacity to 8 bcm / yr. Assuming these are achieved, Peel Hunt has forecast eps of 408 cents (337p) in FY24 while a 109 cents (90p) dividend is expected this year and 164 cents (136p) next.

A director has just acquired 50,000 shares at 926p. *I am a speculative buyer.*

TMI

home US market with key customers including large US oil field contractors Schlumberger, Baker Hughes, Siemens and Halliburton. Importantly, Hunting is able to source its raw materials through strategic partnerships with four of the largest steel mill owners. Three are in China: Hyst (Hunan Province), Baosteel (Shanghai), Jiuli (Huzhou City) alongside Jindal Saw in India and are perfectly positioned to help Hunting expand outside the US with international now 20% OCTG sales.

Energy transition to add US$250m by 2030

Hunting believes OCTG will increase sales by 19% in the two years to 2025. Punchier still is that it expects it to contribute as much as 40% of the growth between FY25-FY30 to reach its US$2 billion goal. Its confidence is based on expansion in so-called energy transition markets such as geothermal heating, which is expected to almost double global capacity by 2030, and in carbon capture utilisation & storage (CCUS) and it's targeting an additional US$250m revenues from energy transition by 2030. In Geothermal, which again involves drilling deep, Hunting's pipes and connections are used because they can withstand very high temperatures with high resistance to corrosion, which is achieved through increased nickel content.

Perforating Systems

Next down in terms of size is Perforating Systems (30% forecast sales), which was Hunting's leading business in the early 2010s when oil prices were high. Its emergence came thanks to the arrival of shale (or tight) oil & gas fracking as the dominant force in US energy production. After encasing a well to prevent any leaks, the fracking process consists of pumping mainly water but also chemical additives and sand down the shaft at very high pressure to fracture surrounding rock and create cracks and fissures through which the oil & gas then comes out. Titan supplies the perforating guns, which perforate (or shoot / blast holes in) the well shaft casing to allow hydrocarbons to flow into the well shaft from the surrounding rock outside. These perforating systems are used in the completion phase of the well, that is making the bottom of the hole ready for production. Its range also includes shaped (explosive) charges, detonating cords, firing systems, inspection and logging tools and various connections.

Trading wise, Hunting expects 10% growth this year in spite of reduced drilling rig activity in the US.

Sub Sea / Advanced Manufacturing

Excitingly, Hunting believes its two smaller product lines, Sub Sea and Advanced Manufacturing, will grow sales in the high 20s% by 2025. The former makes titanium stress joints, parts for floating production and storage offtake (FPSO) platforms and hydraulic couplings and valves for "Christmas Trees" control systems that sit on the ocean floor and manage pressure to ensure no blow-outs. This side is benefiting from soaring demand in places like Guyana, Brazil and West Africa, countries previously starved of investment.

Advanced Manufacturing is also going like a train, benefiting from Hunting's determination to increase non oil & gas revenues from 7% to 25% of an enlarged base by 2030. It manufactures precision engineered parts such as turbines for Pratt & Whitney and GE and gear shafts and rotor blades for helicopters; periscopes for the US Navy; rocket parts for Space X; measurements while drilling in electronics and other products for the medical sector. As Ferguson says, it takes considerable time to be qualified as a supplier but the reward is sizeable contracts and high margin work.

Cost cuts boost margins

While the prospects for top line growth make Hunting an exciting proposition, an added benefit is that it has undergone a deep restructuring, involving a one third reduction in staff to 2,000, closure of several distribution centres in the US, a reduction in Singapore manufacturing facilities from three to one, and the exiting of a pipe trading business. All told, that's reduced fixed costs by US$40m with a further US$6m expected by 2025 and Hunting says its revenue / EBITDA break-even has reduced from c. US$520m to just US$425m. The effect on profitability has already been explosive with EBITDA margins expected to recover from 7% in FY'22 to 10-11% this year and with 14-16% expected by FY'25 and further gains by 2030, one can see how Hunting could continue to beat forecasts.

445p price target

Investec has a 445p price target, some 50% above today's level. The shares were extremely volatile earlier this year but have settled down with new highs in recent months. *When investors wake up to the fact that its fortunes are no longer tied to oil rig counts, I believe the shares will re-rate. I am a buyer.*

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Cake Box

Sector: AIM, Travel & Leisure | Share Price: 135p | Epic Code: CBOX

Key Data
Address: 20-22 Jute Lane, Enfield, London, Middlesex, EN3 7PJ
Telephone: 020 8050 2026
Shares in issue: 40m
Market Capitalisation: £54m
Next Results: Interims: November

Markets may have been tough in 2023 but history shows that quoted franchise businesses can make a lot of money for investors in both fair and inclement conditions. For example, in the USA shares in Dunkin Brands, famous for its Dunkin Doughnuts, bagels and coffee, have over the past 10 years quadrupled to US$105 / share while Starbucks has risen from US$4 to US$94 in just over two decades. Back on this side of the pond, Domino's Pizza UK & Ireland, which dominates the pizza delivery sector, has soared from under 4p in 2000 to over 350p. In normal times these businesses can command PEs in excess of 25x because they throw off huge amounts of free cash. They lend out their name (with all the inherent brand benefits) and provide support - the right location, marketing and product ingredients - and in return receive an up-front fee plus ongoing percentage of the franchisees' sales. The downside is therefore limited and yet they benefit when the franchisees grow sales and add new sites.

Sales up six-fold

Aside from Domino's Pizza UK & Ireland, which has become a far larger business with a market cap of £1.4bn, another quoted franchise play in the UK is Cake Box, which operates a chain of franchise stores selling egg-free fresh cream celebration cakes. Cake Box differs from Domino's in that it doesn't charge a percentage of franchisee sales but still earns good returns from charging an-upfront fee and ongoing sale of cake ingredients. It has already delivered an impressive run of growth, and between FY16 and FY23, Cake Box's sales have increased from £5.6m to £34.8m with pretax profit up from £1.17m to £5.4m.

Store target upgraded from 250 to 400

As we look forward, I think Cake Box could significantly outperform Domino's and become a terrific investment. While there are now over 1,200 Domino's stores in the UK, Cake Box still only has 205. While its pre-IPO target was 250, in a stunning development last June management upgraded this to 400 outlets, noting it still has little representation in Wales, East Anglia, the South and South West.

In conjunction with this upgrade, Cake Box expects to open an additional 20-25 franchise outlets annually against that base of 205 and has announced a new corporate target to increase franchisee sales from £72m in FY'23 to £100m in FY'26. That's a near 40% increase and compares with broker Liberum's more cautious forecast for Cake Box to grow sales by 26% (from £34.8m to £44m) in the same period. Clearly, it has the bit between its teeth and investors can expect a return to double-digit eps growth in the years ahead.

Eps to grow 31% by FY'26

In spite of the up-beat mood Cake Box, like many small companies at present, finds itself trading on a rather depressed rating. Based on Liberum's forecast for eps to increase from 10.6p to 10.9p, 12.1p and then 13.9p in the three years to 31st March 2026 (growth of 31% in three years), the prospective PE drops to 11.2 and then 9.7. Strip out its net cash of £6m (11% market cap) and the forward PE drops to just 10 versus a previous peak of 31x during the market boom in late 2021. There's also a generous dividend of 8.4p making for a yield of 6.2%.

Strengthens key functions

The obvious question is why such a depressed rating? Aside from the market torpor, much of the bearish sentiment relates to several historic set-backs, which were temporary in nature. The start of its difficulties occurred in January 2022 after it disclosed transcription errors in its 2021 results and annual report, and other inconsistencies related to director interests in franchised stores. Although these had no bearing on the financials, Cake Box quickly strengthened its team, appointing a new COO, chief commercial officer, marketing and IT and customer service directors as well as various management appointments in IT, finance, procurement and health & safety.

Line is drawn in sand

Second, the unprecedented heatwaves in 2022 wiped out 12 days, keeping consumers away from its stores. Third, an unusually high number of people flew out for an overseas holiday that summer after the Pandemic and fourth there was a huge cost inflation spike, which affected key ingredients such as cake mix, fresh cream, shipping freight rates (affecting the cost of cardboard boxes) and energy.

But since colourfully being hit by those four buses, the outlook has improved. H1 trading (six months to 30 September) was in line, with revenues up c. 6% year-on-year while its capital markets day (CMD) presentation noted a decrease in some costs such as fuel, milk, whey protein and energy while the others remained stable. As a result a line has been drawn in the sand and the group now expects adjusted profits to be ahead of H1 22.

Founded in 2008

Cake Box was founded as a single shop in East London in 2008 by CEO Sukh Chamdal who has worked for over 37 years in food manufacturing and retail having started out in the family business selling Indian sweets and savouries before owning a food catering company supplying vegetarian food for functions and events. The number of outlets has grown quickly in recent years from 86 in 2018 to 205, in turn driving up gross franchise sales from £25.9m in FY'18 to £72.1m in 23.

Hollywood Bowl (BOWL), 261.5p

Ten pin bowling centres have long been characterised as smoke filled halls dominated by cheap beer but the arrival of large chains has seen them smartened up with clean surroundings, better lane technology and a decent food offering, attracting a broader and more family-oriented clientele. Hollywood Bowl is one of the two companies (alongside **Ten Entertainment**, 290p) that dominate the UK bowling scene and its excellent value-for-money offering - just £25 for a family of four - has coincided with a wet summer (always good for indoor entertainment) to drive a strong performance in the year ended September FY23. A recent update disclosed underlying sales growth of 16.2%, well ahead of expectations and analysts have upgraded their forecasts.

Formed in 2010, Hollywood Bowl now operates 71 bowling centres in the UK from Dunfermline in Scotland to Torquay in the South West. Its centres are located in high footfall areas (e.g. next to cinemas), either in out-of-town leisure parks or in retail / leisure mixed-use shopping centres, but never in city centre high streets.

Hollywood Bowl is at the forefront of the "corporatisation" of the industry with its centres modern, well-lit affairs where customers can enjoy sofas and tables for drinks in each lane as well as a TV to display real time scores and provide exciting graphics if a player does well. The game involves each player given two balls to carry (knock over) all ten pins, which are grouped in a triangular shape at the end of a narrow lane, over 10 rounds of play. If all 10 pins are carried with just one attempt (a Strike), the player earns double points for the next two rolls.

A startling statistic is that like-for-like sales are 46% higher than 2019 levels and there are a number of factors behind this. These include investment in infrastructure, such as a new zonal sound system and lighting, which can be varied in different parts of the centre, bringing back popular dishes to the menu that were canned during the Pandemic, while combining bar and dining areas to release extra space for bigger and better amusement machines. Another key driver is increasing utilisation, such as by discouraging food eaten while playing to speed up games and this has helped increase return on capital employed from 3.5% in FY20 to 18%.

Where Hollywood Bowl is head and shoulders above the competition is that it holds net cash of £52.4m (plus an un-drawn £25m borrowing facility) and is well-placed to expand its estate. There were three new openings in FY23 with a further 15 targeted before the end of FY26. Each new unit costs a gross £2.4m to fit out but landlord contributions and long rent free periods in return for long leases with five-year rent reviews reduce this to £1.8m. Return on investment on recent openings is said to be 35%. As well as bowling centres, the group has also opened four *Puttstars*, a mini-golf concept but management believes returns are higher in bowling.

Where it gets particularly interesting is that the group has added a second leg in Canada following the acquisition of Teaquinn in May 2022 for £10.6m (5.2x EBITDA), which brought in five ten-pin bowling centres. Since being acquired, this has increased to nine. The group says Canada is relatively undeveloped and similar to the UK 10 years ago, while the country is relatively rich, ranked eighth globally on total wealth measures while 80-90% of the population live within 100 miles of the border with the USA. Crucially, Hollywoood Bowl is well represented in these areas with five centres in: Toronto, Ontario (the largest city with a population of 2.8m) and a further three in Calgary (population: 1.5m), Alberta and one in British Columbia. The plan is to triple the estate to reach 30 outlets in the next 10 years.

Investec has upgraded EBITDA forecasts for FY'23 by 9% to £81.2m with eps up almost 4% to 21.4p. For FY'24 -FY '26 they have been raised 4%, 10% and 16% to 20.9p, 22.3p and 24p dropping the prospective PE to 12.5 and then 11.7. The broker has a target price of 430p. *I am a buyer.*

It seems we are officially a sweet-toothed nation. Cake Box says 91% of people eat sweet baked goods while 50% of the population are "habitual sweet snackers," treating themselves at least three times a month. A Mintel report shows that the market for cakes, cake bars, sweet baked goods and celebration cakes has grown 11.5% to £2.5bn and is forecast to expand again to £2.8bn by 2026.

Differentiates from rivals

In a crowded market Cake Box differentiates itself from the supermarkets, cafes, bakeries and independents in several ways. First, it is the only specialist operator with genuine national reach; second, it only sells egg-free cakes, providing a choice for those challenged with allergies or food intolerances. Third, it has a wide range, from fruit gateaux, cake slices and cheesecake platter cakes to cup cakes and fourth, customers can receive a free personalised messaging service in store or personalised photos printed on sugar paper, added to any cake.

New product development is also driving momentum. Chamdal, who I met again over the month, says the group is launching new premium ranges including Vegan Cakes on World Vegan Day (1st November), retailing at £36 for an eight inch cake versus standard price of £22-£26, butter cream cakes are under development while a new line in brownies has been launched.

At the same time Chamdal is increasing average basket sizes (now £33 versus £31 pre-Pandemic) by adding gift options such as balloons, candles, chocolates and smart cake tins.

46 multi-store franchisees

The engine room driving business expansion is the opening of new franchisee stores. Cake Box procures new franchisees via its website, recommendations from other franchisees, via the group's customers or through existing franchisees expanding their empire. The latter has become a particularly lucrative source; back in 2019 there were only 20 multi-store franchisees but that has since increased to 46. Nine operate with five or more stores, 22 have three or more and a further 64 have at least two.

Successful candidates initially pay a £5,000 deposit followed by a £135,000 up-front fee to open the store. This covers site identification; store fit-out; and training. In addition, the franchisee must buy Cake Box's centrally manufactured cake sponges (two varieties only of plain sponge or chocolate) from its three sites in Enfield, Bradford and Coventry as well as other supplies including boxes, decorations, balloons, uniforms, stationery and other branded items.

At a time when interest rates have risen, you might expect fewer takers for a franchise but Chamdal says franchisees are drawing on more on their savings to reduce the need to take on debt but Cake Box is willing to offer a low cost loan covering a third of the requirements, with the rest funded by banks.

Gross margins rise

The package is lucrative to both sides. For the franchisee, average weekly sales for a mature store will be around £6,600, which equates to c. £343,000 a year while cash EBITDA is estimated to be £85,000 and payback on investment only 20 months. Little wonder the pipeline is strong.

For Cake Box, the "payoff" is in the ingredients it sells to its franchisees, in particular the cake sponge, which generates a whopping 70% gross margin. As the company gets bigger and the ratio of mature stores to new ones inevitably increases, a greater proportion of sponge will be sold and this will drive profitability higher. Analysis shows that in the first year a store will generate sales to Cake Box of roughly £200,000 (including the initial fee) and make a gross margin of 30%, i.e. £60,000 profit contribution. In subsequent years as the store matures, gross profit increases to c. £160,000 for a gross margin of 50% or even 55%. For Cake Box as a whole, in FY23 sponge sales increased almost 11% to £13.6m and now comprises 39% group sales from 37.2% the previous year. That in turn has driven up gross margin from 48% to 49.4% in spite of rising costs.

Broadens distribution channels

The other way in which Cake Box is growing is by broadening its distribution channels. The group has already established 18 kiosks (FY22: 15),

which are based at shopping centres and are run by existing franchisees and increased their sales contribution by 15% to £5.6m, almost 8% of franchisee sales. More recently it has launched a new website and is now able to send product direct from head office. Online sales accelerated in H2 23, growing 9% to £7.2m.

New database launch

Excitingly, Chamdal has recently launched a central marketing fund that will see franchisees pay 1.5% of their sales, which will raise £1m a year. The group is matching that to make £2m. The idea is to raise Cake Box's brand awareness (currently 40%) through radio ads, outdoor marketing on telephone booths and bus stations, and social media. It's already number one on Google for searches for "birthday cake."

Cake Box has also invested in consumer data driven marketing with a new CRM system driving nearly 80,000 SMS subscriptions and close to 300,000 marketing ones. Cake Box offers a free cup cake to anyone who provides their personal details (name, postcode, telephone, d.o.b etc.) in order to build a larger database and sends e-mail reminders ahead of birthdays, anniversaries and religious festivals; there's lots of demand for Eid, Diwali and Chinese New Year, for example. More detail on this will be provided at its interims on 14 November.

£6m net cash

Without the burden of hefty capex to kit out new stores free cash generation is impressive and in spite of £2m investment (production equipment, ERP system and refrigerated vans) and £3.1m on dividends, it still increased net cash from £5.2m to £6m.

As an asset light, high margin and cash generative business, Cake Box deserves a higher PE rating and Liberum has a 200p price target. Given the company turned down a bid approach at 160p back in July, there's also a possibility of a repeat if the price doesn't improve. *I am a buyer.*

Updates, upgrades and downgrades

Volution (FAN) 384p
Sector: Construction

The effects of global warming can once again be seen in the extraordinary autumn weather with balmy temperatures seen here and in mainland Europe. Such events and the added urgency on Governments to reduce carbon emissions help explain the strong performance by Volution, the market leader in domestic ventilation products and systems, which has said FY23 results were slightly ahead of forecast with the UK (c. 50% revenues) the key driver.

Revenues grew 6.6% (5.1% organic) to £328m and pretax profit rose almost 7% to £65.1m. The UK grew 8.3% like-for-like with residential markets, helped by strong landlord demand (damp /mould), growing 19.5%. Europe was slower (+0.6%) particularly Germany and the Nordics due to new-build contraction. However, ClimaRad in the Netherlands and ERI were more resilient.

While construction markets remain subdued heading into FY24, Volution will benefit from first full-year contributions from I-Vent (decentralised residential heat recovery in Slovenia and Croatia for £21.7m) and VMI (£7.9m, France) while post year end it completed DVS (£8.5m, New Zealand).

Shore Capital expects regulation around indoor air quality and management "to incrementally tighten in the next five years…" and it also highlights value accretive M&A as a source of eps growth. Net debt fell from £61m to £58.1m (net debt / EBITDA: 0.8x) even after those deals, leaving plenty of firepower. Consensus forecasts have nudged up to eps of 25.9p and then 27.4p in FY'25, dropping the prospective PE to 14.8 and then 14.0. *I am looking to buy on dips*.

Essentra (ESNT) 155p
Sector: Industrial Services

Essentra's third quarter update revealed a slight improvement in trading with like-for-like revenues of -7.1% during the quarter (versus -11.9% in H1). Europe Middle East & Africa softened reflecting weak business surveys, the Americas saw further de-stocking while Asia Pacific recovery remains slow due to weakness in China. That said, operating margins remain strong with all regions maintaining robust pricing and disciplined cost management.

The BMP Tappi acquisition is about to close shortly.

Broker RBC has nudged down eps forecasts to 10.3p and 11.8p for FY'23 and '24. With just 4% market share in a US$8bn-US$10bn market, strong manufacturing and distribution capability and 18% medium term margin target (versus 12.7% in FY22), Essentra will come out of the traps quickly when the down-turn fades. *I am a strong holder.*

Vistry (VTY) 744.5p
Sector: Home Construction

The months of September and October have seen a chillier wind blowing through the new build housing market as higher interest rates start to bite and even though Vistry has reduced its reliance on private new build sales in favour of social housing and build to rent, it's not immune. Its Q3 update said it now expects £450m pretax profit for the year versus previously expecting to exceed that number. Vistry also flagged £40m one off costs from the reorganisation to a single Partnerships division and some extra interest costs.

As a result, Peel Hunt has downgraded pretax profit forecasts to £406m for 84.4p. For next year and FY25 they rise to £430m and £545m for eps of 89.9p and 117.8p, respectively. Its target price is 1300p. *Vistry is probably the most resilient house-builder for its diversification towards affordable / social housing and remains a buy.*

Loungers (LGRS) 189p
Sector: AIM, Tourism & Leisure

A positive update from Loungers, which noted like-for-like sales accelerating from +5.7% in the first 12 weeks of FY'24 to almost 10% in the second 12 weeks as its unique all-day trading, value for money casual dining concept resonated with hard-pressed consumers. Overall, H1 was up 7.7%.

The group opened a further 16 sites in the first 24 weeks (with Peel Hunt forecasting 34 for the year) and these are wholly financed by internal cashflow. Encouragingly, new sites are beneficiaries of lower commercial rents, with the broker expecting average cash return on capital employed maintained above 30% and this has increased average EBITDA contribution per outlet. Peel Hunt says, "combined with diminishing inflationary pressures this should lead to improving margins which are not reflected in forecasts."

The broker forecasts pretax profit to increase from £9.4m to £11.2m in the year to April 24 and then £15.2m in FY25 for eps of 11.2p and 15.2p. Peel Hunt says there's room for 600+ Lounges and 50-60 Cosy Clubs against its current estate of 238 outlets so a big prize longer term. *With the prospective PE dropping to just 12.4 next May, I am a buyer.*

Topps Tiles (TPT) 47p
Sector: Retailers

While there's gloom in parts of the RMI sector, Topps Tiles has shown resilience with its fourth quarter update confirming a third successive year of record sales. In Q4 it grew sales by 3.2% while for FY'23 as a whole it posted £263m. That's up 6.4% year-on-year. It's also £40m higher than FY'19 with sales per store up 30% as a result of organic growth and the store rationalisation program. Topps also significantly outperformed the tiling market with market share expected to "strongly increase" from 19% last year as it moves towards its goal of "1 in 5" by 2025.

Bright spots also included online (*Pro Tiler Tools* and *Tile Warehouse*), which grew sales by over 40% in Q4 while the struggling Commercial operation was boosted by a 35% operating cost reduction.

Overall, trading remains in line with expectations. *I am a strong holder.*

At the time of going to press, the editorial team held the following shares mentioned in this issue: Telecom Plus, Reach, Essentra and Marstons

Updates, upgrades and downgrades

SigmaRoc (SRC) 50p
Sector: AIM, Construction & Materials

You might expect a business like Sigmaroc, a "buy and build" owner and operator of quarries in the UK and Europe, supplying bluestone and limestone as well as other aggregates and ready mix concrete, would have been battered, given the housing market downturn. However, it's held up pretty well with trading in line with expectations. Third quarter figures showed revenues up 7% like-for-like, largely thanks to a 11% price increase with volumes sold falling 4%.

Softer residential markets have been offset by robust infrastructure and industrial minerals activity, but the main highlight was EBITDA margins improving from 20% to 22% as a result of organic improvement projects and some easing of energy costs.

SigmaRoc continues to deliver new projects and products such as carbon capture unit, Aqualung (the ArcelorMittal lime kiln JV) and new products at CdH (Puccini Blue) in Belgium and at CCP in Wrexham.

As Liberum notes, SigmaRoc's strength is its product and geographic diversity and decentralised operating model and in spite of tough conditions continuing, the company has left guidance unchanged with eps of 7.6p and then 8.2p in FY'24, dropping next year's prospective PE to just 6.1.

Liberum believes the shares will re-rate "to a more fitting valuation as SigmaRoc extends its financial track record, proving the resilience of its diverse activities and continues to acquire businesses at attractive multiples and improving their profitability." Its price target is 120p, more than double today's level. *My gut feel is we're close to the bottom. I am a buyer.*

Capital Limited (CAPD) 79p
Sector: Mining Services

Capital's third quarter update revealed unchanged guidance for the full year for revenues of US$320m-US$340m, which would be another record.

In Q3, revenue rose 9% year-on-year to almost US$80m. Drilling revenue was 2% lower at US$51.2m, missing expectations, reflecting seasonal wetness in West Africa, and a contract in Mali put on hold due to civil war breaking out earlier this year. Management expects a strong Q4 reflecting a ramp up in activity at its Reko Diq and Ivindo drilling contracts, plus the return of a third, Meyas Sands.

Elsewhere both mining services (+38% to US$18m) and the PhotonAssay business MSALABS (+36% US$10.5m) enjoyed strong periods. Capital aims to increase the number of PhotonAssay units deployed from the current 10 to 21 by FY'25 with revenues expected to reach US$43m this year and US$90m by FY'25.

Peel Hunt has left forecasts unchanged for pretax profit of US$36.1m and US$53.3m in FY'24 for eps of 12.8 cents and 19.9 cents (16.4p). Mining Services, which enjoys longer life contracts and the higher margin PhotonAssay business together make up over 30% of revenues, but this higher quality mix is not reflected in the FY24 PE multiple of 5.0.

The broker's price target is 153p. *I am a strong holder.*

Hostelworld (HSW) 119.5p
Sector: Tourism & Leisure

A well-timed addition to Trader Portfolio 2 with Hostelworld increasing FY23 EBITDA guidance to €17.5-18m, a 6% upgrade. This reflects record year-to-date GMV and revenue of €496m (+38% year-on-year) and €75m, respectively, in the first nine months. Net bookings grew 43% to 5 million. Marketing efficiency has also continued to improve as the proportion of bookings made by social members (low or no cost of customer acquisition) increased to 59% in September. As a result direct marketing as a percentage of revenue has fallen to 51% (down 10% year-on-year).

Encouragingly, the strong earnings growth also dropped through to cash with net debt down from €16.2m at end of H1 to €13.4m. With net debt / EBITDA now below 1x, the interest rate has reduced from 325 basis points to 265 bps over EURIBOR.

The shares look cheap on a prospective PE for next year of just 10.9 (eps: 12.6 cents). *I am a buyer.*

Telecom Plus (TEP) 1646p
Sector: Telecommunications

After rising more than £10 to a peak of £25 late last year before falling back to £14, shares in Telecom Plus, a low cost provider of utilities to private households, such as energy, phones and insurance, bounced sharply after it announced a strong first half FY'24 as the cost of living and energy crisis forces consumers to shop for better deals. It said it won an additional 62,500 households, equivalent to an annualised growth rate of 14% and "with 949,180 households now taking its services it's comfortably on track to double the size of its base over the medium term."

Meanwhile, Telecom Plus has refreshed its relationship with long-term energy supplier E.ON, which should enable greater flexibility and innovation. Numis says the group will now be able to offer numerous attractive fixed-price tariffs; expand its target market to include small businesses; also develop "time of use" tariffs for EV charging / home generation & storage.

The group will invest modestly more in the next few years to help its expansion into adjacent market segments. Reflecting this, its eps forecast has been trimmed to 107p in year to March '24 with 117p in FY'25 and 132p in '26. Nevertheless it believes the shares are significantly under-valued on a prospective PE of 15.4 and then 14.1 and has a 2900p price target. *I am a buyer.*

Marstons (MARS) 31.5p
Sector: AIM, Ind Transportation

Despite the share price weakness, pubs operator Marstons has enjoyed broker upgrades following its latest update. Managed and franchised like-for-like sales rose 10.1% in 2023, an improvement from the 6% growth rate in the first half. Encouragingly, sales growth accelerated to 12% in the last five weeks of the period. Much of the improvement reflects increasing levels of travel and customers accepting price rises in March and April, while management highlights the resilience of the community pubs estate.

With all energy costs and a significant proportion of food and drink costs fixed for 2024, Marstons now targets improving margins by at least 200 basis points (bps) over the next 2-3 years. Around 50 bps will come from a recent £5m reduction in head office headcount.

It's not out of the woods just yet. Marstons has reduced net debt by £31m to £1,185m during FY'23 after £55m disposal proceeds. It targets a further £60m-70m in FY'24.

However, Peel Hunt has upgraded pretax profit forecasts by an average 10% to reflect said lower head office costs and higher pub margins, which more than offset rising interest costs. New PBT is £59m and then £65m for eps of 8.1p and 8.9p. Its price target is 75p. *That's enough encouragement to hold on.*

Reach (RCH) 80p
Sector: Media

Given the tough macro climate, the fact that Reach's Q3 update confirmed trading remains in line almost felt like a "beat" and the shares rallied. Revenues declined by 7.8% with print outperformance (-5.8%) offsetting weaker than forecast digital result (-13.7%), which reflected a dip in traffic, partly caused by Facebook winding down the promotion of news content on its websites. For the nine months, Reach indicates a 21% decline in traffic but expects improvement (as the annualisation moderates) in Q1 next year. Data driven revenues rose to 42% of total Digital revenues for the 9 months, which Panmure says implies an increase from 41% in H1 to 44% in Q3. Once it gets to around half the total investors should really take note of the improving earnings quality.

Encouragingly, Reach confirmed it is on track to deliver 5-6% reductions to its cost base.

Rather annoyingly Reach has said it will increase pension contributions at its largest scheme, MGN, by £5m a year and until 2028 (from 2027) to plug a widening deficit while it expects to hear the court case decision regards the key time limitation issue for the phone hacking within the next few months.

With net debt expected to only modestly increase to around £20m by FY24, Reach is strong enough to get through the economic maelstrom and benefit from the eventual recovery. Yet the shares look cheap on a prospective PE of 3.5 (eps: 22.6p). *I am a buyer.*

TMI Trader Portfolio 2

Sentiment has improved amongst UK small caps, perhaps in response to the second consecutive "hold" on interest rates by the Bank of England and an improved 6-3 vote split (from 5-4). Historically shares have rallied as investors front-run the next base rate cut, which is now expected before the summer. Hedge funds which had been short are now exiting their overcrowded trades. So in 2024 you could see some large re-ratings with shares "gapping" higher on news which may often be in line (given the low PEs) - and a lag effect means that this will still happen even if unemployment rises, more companies fail and the media wails about a never-ending recession.

The market updraught has helped TP2 rise 1.6%, mainly due to a rally from H&T while DX rose as the take-over moves closer to completion. Hostelworld raised EBITDA guidance 6%, driven by a 43% increase in bookings and marketing efficiencies thanks to more social members. With debt down sharply, the shares are cheap on a prospective PE of c. 11x.

Elsewhere, Reach maintained its forecasts, which these days feels as good as a beat given the tough macro situation. The increased pension contribution is annoying but the main reason to hold these was always about the large growth in advertising yields from its personalised data driven revenues. These now comprise 42% digital revenues and could enjoy a windfall when Google Chrome switches off its third party cookies in H2 '24; somewhat overlooked is that Reach operates an AI driven tool, Neptune Recommender, which "serves users content more tightly related to their interests than ever… preparing publishers for a cookieless future it increases page views, user dwell time and engagement".

Following a call with finance director Bruce Ferguson, I lead with Hunting, which provides oilfield services such as steel pipes down a well shaft and perforating guns for fracking in shale formations. The geopolitical crisis could see a massive oil price spike but Hunting has been enjoying substantial upgrades even without that. The order book has grown while contract wins have become larger with longer duration. The secret? A diversification into faster growing markets such as geothermal and carbon capture utilisation & storage (CCUS), alongside deep cost cutting to lift margins. Trading on a lowly prospective PE of 9 and then 6.7, they look a conviction buy for TP2 and I will look to add them in the months ahead.

I've also revisited franchise business Cake Box after a follow-up with CEO Sukh Chamdal. Earlier this year it upgraded its store target from 250 to 400 underwriting many more years of growth while its recent move to charge franchisees 1.5% sales to build up a central advertising pot for raising brand awareness is right out of the Domino's Pizza playbook. The forward PE of 11.2 and then 9.7 is dirt cheap while the 6.2% yield is enticing.

PERFORMANCE TABLE

	Current Value	Change on One Month	Change Since Start
TMI Trader Portfolio 2		+1.6%	+ 4.5%
FTSE-100	7410	-0.6%	+25.5%
FTSE-Small Cap	5901	+0.2%	-1.1%

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.	30,000	*	DX Group	16/11/20	19.5	5,895	44.5	13,350	+126
CAML	4,250		Central Asia Metals	21/12/20	224	9,565	166.5	7,076	-26
RCH	3,600		Reach	21/6/21	263	9,560	80	2,880	-70
ESNT	3,000	+	Essentra	22/11/21	284.2	8,571	155	4,650	-46
SRC	11,000		SigmaRoc	16/3/22	83	9,175	50.5	5,555	-39
BAB	2,800		Babcock	14/4/22	323	9,134	405	11,340	+24
HAT	2,600		H&T	7/7/22	361	9,431	473	12,298	+30
PTEC	2,400		Playtech	26/9/22	378	9,162	424	10,176	+11
MOON	6,500		Moonpig	23/5/23	135.5	8,897	165	10,725	+21
LUCE	7,500		Luceco	2/6/23	123	9,316	112.5	8,438	-9
HSW	7,250		Hostelworld	20/9/23	126	9,226	119.5	8,664	-6

* Part profits taken + Acquisition price adjusted for special dividend

Starting capital £100,000 (December 2020)

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

Stock value	£95,152
Cash	£9,343
Total fund value	£104,495

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• *Unless otherwise stated, share prices quoted are correct as at 3/11/23*

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