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VOL 20 / ISSUE 24 / 21 JUNE 2018 / £4.49

SHARES

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Why company break-ups can release hidden value and benefit shareholders

WHY THE FTSE 100 IS ONLY REALLY DRIVEN BY **4 SECTORS**

HOW TO AVOID *THE BUY-TO-LET CRACKDOWN*

Operational gearing can have a nasty impact when things go wrong

Connect is a good example of how low margin companies get in a mess on the smallest drop in revenue

Rapid growth in e-commerce demand may lead some investors to conclude that transportation companies fulfilling orders would be superb investments. You may think again after analysing the horrific profit warning on 13 June from logistics group **Connect (CNCT)**.

Revenue for its Tuffnells delivery business fell by 12.3% in its third quarter (or down 3.9% over nine months) amid lower volumes, plus costs have risen.

A logistics company is likely to have limited flexibility on cost as it still has to maintain a core service, so it is hard to see Connect making drivers redundant and selling off vans to save money.

The task has always been to increase utilisation of the vans and optimise route density, making sure they are full and not having to travel long distances to make a single delivery.

OPERATIONAL GEARING IMPACT

Let's take a hypothetical situation of a company called Delivery plc which last year made £300m revenue and had £291m operating costs, giving it £9m operating profit.

Net interest costs were £7.5m which meant pre-tax profit equated to £1.5m. Tax at 19% was £0.3m, leaving it with £1.2m net profit. With 100m shares in issue, earnings per share was 1.2p which twice covered its 0.6p dividend per share.

Revenue then drops by 5% in the current year, taking its sales to £285m. Based on costs remaining the same at £291m, operating profit is wiped out and it makes a £6m operating loss.

Management will now be under pressure to cut the dividend.

This example demonstrates the effects of operational gearing and how they can severely hurt low margin businesses. A small reduction in revenue can have a major impact on earnings strength and is relevant to Connect's latest update. It's no wonder that analysts have slashed Connect's dividend forecast by 80%.

NO ROOM FOR ERROR

The gap between revenue and profit is very small at Connect, hence there is no room for error. It has a 3.4% operating margin according to SharePad. While better than **Royal Mail's (RMG)** 2.7% margin, you have to weigh up stark differences between the two companies.

The latter has a plan to boost margins through automation and more efficient operations, plus it has a highly valuable brand and unique market position for letter delivery.

In contrast, Connect has made a number of flawed strategic moves over the years including the purchase of Tuffnells which operates in a commoditised industry and has an undifferentiated service.

There is no loyalty in the parcels delivery industry: failure to perform a good service will see customers switch to a competitor.

Tuffnells' sudden drop in revenue could well be a result of this situation. It had already warned in May about operational inefficiencies within Tuffnells, flagging a high turnover of depot managers and key operational roles, plus troubles hiring enough drivers.

The lesson here is to treat low margin businesses as high risk investments. Either avoid them completely or keep a close eye on all commentary to spot problems before they elevate into a negative profit shock. Connect's issues were certainly crystal clear weeks before its warning. (DC)

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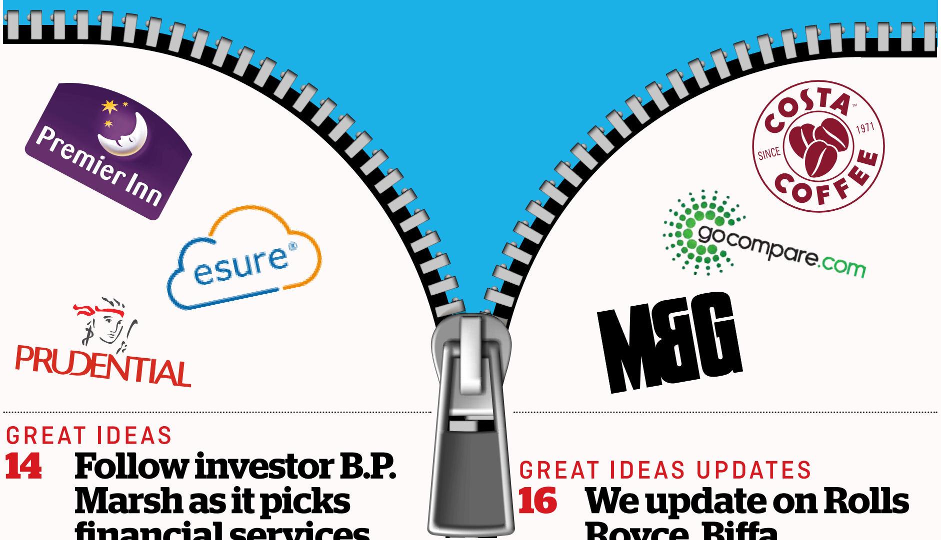

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Shares magazine is published weekly every Thursday (50 times per year) by AJ Bell Media Limited, 49 Southwark Bridge Road, London, SE1 9HH. Company Registration No: 3733852.

BROKER RATINGS EXPLAINED:

We use traffic light symbols in the magazine to illustrate broker views on stocks.

Green means buy, Orange means hold, Red means sell.

The numbers refer to how many different brokers have that rating.

Eg: 4 2 1 means four brokers have buy ratings, two brokers have hold ratings and one broker has a sell rating.

The traffic light system gives an illustration of market views but isn't always a fully comprehensive list of ratings as some banks/stockbrokers don't publicly release this information.

Europe's central bank tightens up monetary policy

The ECB has set the date to stop its programme of quantitative easing. Is the region ready for such a big reversal?

The European Central Bank (ECB) has finally called time on its programme of quantitative easing as it takes steps to tighten its monetary policy.

The central bank will halve its bond purchases to €15bn a month from September and stop completely by the end of the year.

The programme was started in 2015 partly to boost inflation and also to increase growth in the region. Nations such as Germany have grown uncomfortable with the amount of assets held by the ECB, said to be around €2.4tn at time of writing.

The markets have not panicked, probably as a result of the ECB's pledge not to increase interest rates until the middle of next year at the earliest. Across Europe, markets took the news in their stride; the FTSE 100 gained 0.8% on 14 June, Germany's DAX improved by 1.8% and France's CAC rose 1.6%.

One reason for the boost to European indices is the euro sell-off following the announcement. This made European equities cheap and thus desirable.

In terms of UK-listed investment trusts with European exposure, it's a mixed bag. For example, **Jupiter European Opportunities Trust (JEO)** has made gains since the decision whereas shares in **Fidelity European Values (FEV)** have slipped.

Edward Park, investment director at Brooks Macdonald, says zombie companies which may struggle to pay their debts have been allowed to survive as the bond yields have been so low during the period of quantitative easing.

'This is not a problem when central banks are keeping bond yields artificially low, as it is cheap and easy to refinance debt, and zombie companies can therefore continue to meet their financial obligations,' says Park.

However, when monetary policy becomes less accommodative, problems will arise for heavily indebted companies and countries.

Italy is one example of a country that is in a perilous debt situation and will find it harder to meet its debt obligations. It has also just voted in a populist party, the Five Star Movement, which may not be willing to obey the EC's rules.

Some commentators are worried about the lack of an interest rate hike despite the markets seeing it as a positive. Nick Peters, multi asset portfolio manager at Fidelity, says the markets' knee-jerk response was to sell the euro.

'Not only does the Eurozone have to contend with an economy that has peaked and is underperforming the US, medium-term geopolitical concerns, and higher oil prices – now it may not see positive interest rates before the next global downturn, and enter that downturn with very little ammunition,' he adds. (DS)

Indivior's shares bruised as a key rival steps up efforts to launch copycat drug

We explain what's happened at the FTSE 250 company and why analysts think now is the time to buy

It has been a whirlwind week for addiction specialist **Indivior (INDV)** as it continues to fight rivals who are trying to launch generic versions of its Suboxone opioid addiction treatment despite its patent not expiring until 2024.

Opioid addiction is a huge problem in the US with president Donald Trump claiming it is a 'national emergency'. In 2016, over 42,000 people died of opioid overdoses with 40% of these deaths involving a prescription opioid.

Following approval of its Buprenorphine and Naloxone Sublingual Film on 15 June by the US Food and Drug Administration (FDA), Dr Reddy's Laboratories decided to pursue an 'at risk' launch for its generic version of Suboxone. This term describes a situation when a company puts a product on the market before resolving outstanding patent lawsuits against it.

Shares in Indivior toppled nearly 27% to 360.5p on Dr. Reddy's news as the launch of a generic rival could potentially lead to a rapid and material loss of market share for Suboxone in the US in a matter of months.

It subsequently obtained a court order which temporarily blocked Dr Reddy's from launching its product with a preliminary injection hearing pencilled in for 28 June.

In September 2017, the US District Court for the District of Delaware decided the composite of Dr Reddy's drug did not infringe Indivior's patents, but the latter decided to appeal.

Indivior is still in litigation with Teva Pharmaceuticals and Actavis over their generic versions. It has already reached settlements with Par Pharmaceutical, Endo, IntelGenx and Mylan over patent litigation.

Shares in Indivior toppled nearly 27% in one day

SUBLOCADE'S $1BN PEAK POTENTIAL

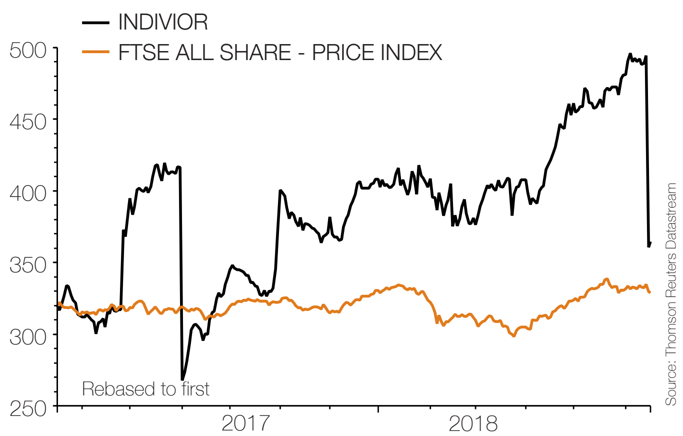
Despite the deluge of litigation that Indivior has pursued to protect its Suboxone patent and try to prevent its rivals from stealing market share, its shares were fairly strong earlier this year thanks in part to the approval of its Sublocade injectable drug, also known as RBP-6000, last December.

Sublocade, which can only be administered by healthcare professionals, is expected to be the largest revenue generating product for Indivior with peak sales potential of $1bn according to stockbroker Numis.

The drug launched in March and is forecast to be a 'far greater value driver' for Indivior according to Jefferies analyst James Vane-Tempest.

He says physicians are anticipated to move significantly more patients on to the drug than the market expects.

Numis analyst Paul Cuddon thinks Indivior's recent share price weakness is a buying opportunity. He flags clarity on generic launches, cost cutting plans and the Sublocade ramp-up as key catalysts. (LMJ)



AVEVA impresses with first full year figures after mega-merger

Engineering software firm shoots the lights out with pro forma profits

FTSE 250 engineering design software supplier **AVEVA (AVV)** beat forecasts for its first full year results since its multi-million pound merger with Schneider Electric's software business (SES), sparking a near 10% share price jump to £27.52.

The £4.3bn company posted better-than-expected underlying growth of around 10% from its core AVEVA business, while the SES side made a welcome return to growth (circa 2.5%), according to calculations by stockbroker Numis which has stripped out a large non-recurring project to give a better representation of how the business has performed.

Earnings before interest and tax (EBIT) of £166m were approximately 13% better than Numis' forecast. That implies 8.9% progress on the previous year's pro forma figures.

AVEVA sells computer-aided design tools used by engineers to design and build large infrastructure projects such as oil rigs and transporter ships.

The company merged with SES in March this year in a deal that effectively doubled the original AVEVA's size. It has lifted cost synergy benefits from the tie-up from £10m to £25m a year.

The stronger trading has been put down to an escalation of oil industry build projects and wider use of digital tools by engineers.

Numis has lifted its March 2019 forecast by around 10% and now anticipates pre-tax profit of £169.6m, rising to £182.1m in 2020. (SF)

New reporting rules could put near-term tech earnings under pressure

Changing the way companies report revenue should encourage greater transparency

NEW REVENUE recognition rules could have a notable negative impact on the tech space, according to investment bank Berenberg.

IFRS 15 is a new international financial reporting standard that came into effect at the start of 2018. The regulation sets out how companies should recognise revenue over multi-year contracts, and for many that will mean spreading income evenly across the contract length. Previously companies have been allowed to book all multi-year revenue upfront.

Berenberg believes this is likely to force some companies to book lower revenues than previously anticipated yet still having to sink upfront costs, such as implementation expenses. That could have a negative impact on current earnings per share estimates which in turn could impact their share price rating.

Berenberg calculates that online training business **Learning Technologies (LTG:AIM)** and **Accesso Technology (ACSO:AIM),** the theme parks software supplier, may also see earnings estimates trimmed potentially by as much as 10%.

The accounting changes will have no impact on company cash flows.

While the reporting changes could temporarily drag down share prices, more conservative rules on how multi-year sales are booked should go down well with investors if IFRS 15 delivers better transparency. (SF)

LATEST TWIST IN SKY SAGA AS COMCAST HUNTS FOX

Shares in the UK-listed pay-TV firm are trading at a premium to the highest offer on the table

JUST WHEN you thought the bid situation around pay-TV firm **Sky (SKY)** could not get any more complicated, US media conglomerate Comcast has launched a $65bn rival bid to Disney for Rupert Murdoch's 21st Century Fox.

Fox currently owns 39% of Sky and was looking to acquire the remaining 61% stake for £10.75 per share when Disney agreed a takeover of its media assets.

Comcast then launched its own higher offer for Sky at £12.50. Both deals were recently given the regulatory green light.

Disney is now under pressure to improve its $52.4bn offer for Fox.

Against this confusing backdrop, Sky shares continue to hover around the £13.50 mark.

BOOKIES HOPING FOR WORLD CUP BETTING BONANZA

Online bets could break records during football's blue ribbon tournament

BOOKMAKERS WILL be rubbing their hands in glee during the World Cup with thousands of punters likely to have a flutter on football's blue ribbon tournament.

Analysts at investment bank Berenberg calculate **William Hill (WMH)** earned a staggering 9.8% of its entire digital net sports betting revenue in 2014 during the last World Cup in Brazil. It is likely to be much more this time round given the shift to online betting over the past four years.

The industry is awash with promotions to pull in punters, led by **Paddy Power Betfair's (PPB)** 'Million Pound Drop' World Cup quiz.

9.8%

N Brown could slim down through store closures

JD Williams-to-Jacamo brands owner could vacate the high street

2%

IN THE FINANCIAL year ended 3 March, less than 2% (£15m) of specialist fashion retailer **N Brown's (BWNG)** £922.2m group revenue was generated from brick-and-mortar stores.

It is therefore no big surprise that N Brown is thinking about closing its entire shop estate which consists of 20 small, loss-making sites. The retailer is primarily an e-commerce player with three quarters of its revenue coming from online. The rest of its sales come from consumer credit interests.

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Aurora is a cracking way to access companies on the mend

The value specialist investment trust more than merits its premium rating

Investors looking to profit from a bargain-hunting style of investing should snap up **Aurora Investment Trust (ARR)** as it provides exposure to high quality businesses with huge upside potential.

Aurora trades at a near-3% premium to net asset value (NAV) of 213.63p, yet *Shares* believes this is more than merited by the manager's superb track record, while the announcement (18 Jun) of a £2m+ fundraising by issuing new shares should increase the size of the trust while boosting its liquidity and marketability.

Phoenix Asset Management Partners assumed management of Aurora in January 2016, since when performance has improved considerably.

Sharing the same investment strategy as the manager's star-performing flagship Phoenix UK Fund, Gary Shannon-guided Aurora achieves long term returns by investing in UK-listed shares using a value-based philosophy.

This is inspired by the teachings of well-known investors Warren Buffett, Charlie Munger, Benjamin Graham and Phillip Fisher.

This approach leads Aurora to invest in high quality businesses run by 'honest and competent management purchased at prices that, even with low expectations, will deliver excellent returns'.

Aurora looks for great businesses when they are cheap, usually because they are having short term issues; if its research is correct these companies should recover and deliver high returns.

Phoenix's contrarian value approach is reflected in the fact the manager will only invest when there is at least 100% upside to its intrinsic value estimate.

Aurora is a high conviction portfolio, typically consisting of 15 to 20 of the manager's best ideas with a high weighting toward the top five stocks.

At last count, these included rejuvenated groceries leader **Tesco (TSCO)**, **Lloyds Banking (LLOY)** as well as Mike Ashley-led sporting goods giant **Sports Direct International (SPD)**.

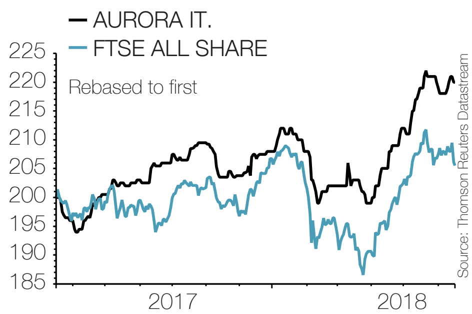
Year-to-date, Aurora has reduced its exposure to housebuilders for portfolio management purposes, having generated strong gains from **Redrow (RDW)**, **Barratt Developments (BDEV)** and **Bellway (BWY)**.

The sole new investment is humbled funeral services provider **Dignity (DTY)**, bought following a 70% share price decline that followed a profit warning in November.

Broker Liberum Capital says 'Dignity is an example of the manager's disciplined, long-term approach, having monitored the company for 14 years prior to investment'.

Also illustrative of the contrarian Aurora approach is the holding in **EasyJet (EZJ)**. While the overall airline industry has a history of losses and corporate failures, Aurora points out EasyJet earns a high return on capital as it operates from airports that are at or near full capacity.

This should limit the competitive threat from new entrants, while the expensive flag carrier airlines 'are vulnerable to EasyJet's cheaper, equally convenient offer'. (JC)



AURORA INVESTMENT TRUST ↗ BUY
(ARR) 220p
Stop loss: 176p

Follow investor B.P. Marsh as it picks financial services winners

The company has a stellar track record and should soon have more cash to deploy

An investor in early stage financial services companies, **B.P. Marsh (BPM:AIM)** has a stellar record and should soon have greater firepower thanks to a forthcoming fundraising which should provide an extra £17m for the business to grow.

The company's recent results show a 24.1% increase in net asset value to £98.4m for its year ending 31 January. The value of the portfolio increased by 31.3% driven by its holdings in financial advisory firm LEBC, insurance company Nexus Underwriting and Lloyd's broker CBC.

During 2017 B.P. Marsh increased its stake in LEBC to 60.9% with a purchase of a further 17.8% holding in the company for £7.1m. B.P. Marsh recently said the company is trading significantly ahead of last year. LEBC also acquired Bristol-based advisory firm Aspira for £5m, aided by a £1.5m loan from B.P. Marsh.

It's rumoured that LEBC is going to float on the London Stock Exchange next year which could result in an increased valuation of B.P. Marsh's holding. During the past financial year the company made a 63% paper gain on LEBC with its stake now worth £33.2m.

B.P. MARSH BUY
(BPM:AIM) 283p
Stop loss: 220p

Market value: £83m

Savvier investing from B.P. Marsh is indicated by its 17% stake in Nexus which has increased in value by 47.6% in a year to £20.5m.

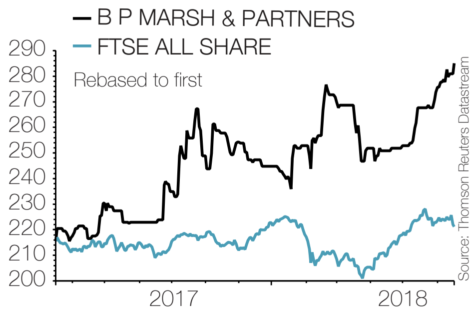
The company's small investment in broker CBC demonstrates its expertise; it turned a £4,000 investment into one worth £2.3m in the space of a year.

Australian-listed PSC Insurance is to become a 19.6% shareholder in B.P. Marsh, subject to a share placing completing in July. It is investing £15.5m in the business to expand its UK interests, plus there is an open offer for existing B.P. Marsh investors which could raise up to a further £1.5m.

The new money will allow B.P. Marsh to access different markets and provide additional firepower to invest in companies. The new relationship with PSC also allows chairman Brian Marsh to reduce his 60.7% stake in the company to 44.2%, selling some to the Australian company for £2.9m.

What makes this company slightly different from other investment companies is the level of engagement with those it has invested in. For instance the company's chief investment officer Dan Topping also sits on the board of Nexus. One of its directors Camilla Kenyon is on the board of LEBC.

While there is some risk that B.P. Marsh may take a while to find more companies in which to invest, the company has demonstrated the expertise to find the winners in its markets so we're confident it can extend this positive track record. Buy now. (DS)



ROLLS-ROYCE
(RR.) 919.2p

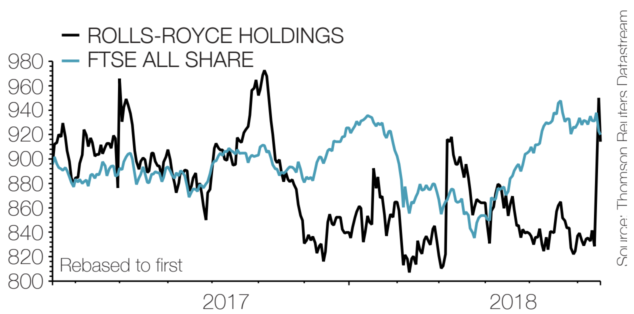
Gain to date: 9.9%
Original entry point:
Buy at 836.6p, 10 May 2018

SHARES IN **Rolls-Royce (RR.)** have hit the £10.00 target we suggested in last month's original *Great Ideas* – they actually touched that level during intra-day trading on 15 June, before closing at 981.76p.

The stock has eased back a bit since but the wave of investor buying shows that the wider market is coming round to our value opportunity way of thinking. What's changed is the company's confidence that it can beat previous operating performance targets, particularly on free cash flow.

Management believe the company could now exceed £1bn of free cash flow by 2020. Forecast free cash flow this year is pitched at £382m. Berenberg analysts predict the business could generate nearly £1.9bn by 2023.

Forecasting performance this far out involves a fair chunk of assumption. But there is a much clearer pathway for performance improvement thanks to Rolls-Royce's streamlining plans that will involve 4,600 job cuts and simply running the business better.



SHARES SAYS: ↗
We remain very comfortable with our buy rating. (SF)

BROKER SAYS: 4 12 5

BIFFA
(BIFF) 248.5p

Loss to date: 1.9%
Original entry point:
Buy at 253.38p, 21 December 2017

WELL-RECEIVED full year results on 13 June mean we've nearly recovered all the lost ground since Biffa's shares took a wobble in March.

Central to previous share price weakness was a restriction on the export of certain recyclables to China, wiping out a valuable source of income for Biffa.

The company reckons China isn't going to change its mind and so Biffa has had to adapt its business, such as finding alternative markets, altering operations to cater for more source-separated material rather than pre-blended, and increased prices as contracts are re-tendered.

Fortunately the biggest part of its business, industrial and commercial, remains in good health with 24.9% growth in 2017 underlying operating profit.

It looks like two energy-from-waste projects are very close to getting the green light, requiring Biffa to invest between £35m to £50m per facility with a targeted mid-teens equity return.

Chief financial officer Michael Topham – who will shortly take over as chief executive – expects to fund this out of the company's debt facilities.

It could push up group leverage from 1.9 to 2.5 times net debt-to-EBITDA (earnings before interest, tax, depreciation and amortisation). Topham says any future small bolt-on acquisitions can be funded from free cash flow.

SHARES SAYS: ↗
We're pleased that Biffa remains focused despite some headwinds. The shares look really great value on 12.9 times forecast earnings for the year to March 2019. Buy. (DC)

BROKER SAYS: 4 2 0

ASCENTIAL
(ASCL) 428.6p

Gain to date: 23.9%
Original entry point:
Buy at 346p, 19 October 2017

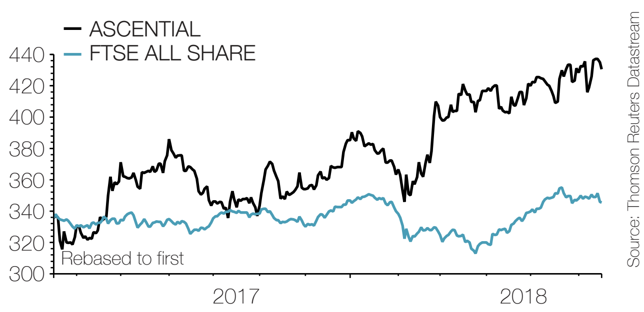
AN INTERESTING acquisition by media outfit **Ascential (ASCL)** is a useful opportunity to update on the progress of a stock we first highlighted in October 2017.

In the interim the shares have ticked along nicely to mark fresh all-time highs earlier in June despite negative analyst comment from Berenberg in April. The investment bank had cut its recommendation from 'buy' to 'hold' and its price target from 420p to 400p on growth fears.

On 15 June Ascential announced the acquisition of marketing intelligence business WARC in a deal worth an eventual £24m, funded from cash reserves and existing lending facilities.

The deal, which should complete in July and is expected to be immediately earnings enhancing, was agreed ahead of the company's key Cannes Lions advertising festival which runs until 22 June. Numbers are down for the festival thanks to a restructuring and a pull-out by French agency Publicis.

The plan is to combine WARC with Cannes Lions' new digital platform The Work to create a product of scale. It fits with the company's ambition for diversifying the business into subscription-based information services.



SHARES SAYS: ↘
Ascential has performed well and we like the business but now could be a good time to book some profit as it switches from asset seller to asset buyer. (TS)

BROKER SAYS: 4 3 1

THARISA
(THS) 110.5p

Gain to date: 10%
Original entry point:
Buy at 100.5p, 7 December 2017

THE CHROME and platinum miner has finally delivered on its promise to make an acquisition or two to boost its future production pipeline.

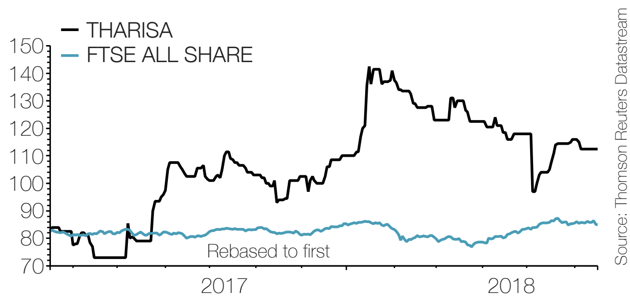
Two acquisitions have been made in Zimbabwe. The first is a 90% stake in Salene which owns an early-stage chrome project. 'It has an easily accessible ore body and, having looked at other projects in Zimbabwe, we believe it should be a low cost mining operation,' the company tells *Shares*. It hopes to build a pilot plant which could generate cash flow within 18 months.

The second deal is a 26.8% initial stake in Karo, owner of a highly prospective platinum group metals and base metal asset. Tharisa is confident of mining multiple open pits for nine years before going underground for 40 years.

The asset used to be owned by Zimplats but was relinquished under a government initiative to bring in new participants to the country's platinum industry.

Tharisa's bull case for the project would require it to build a smelter and refining facility including spare capacity to treat material from other nearby mines. The first of four phases could see it start production in 2020.

The miner insists these investments won't alter its current dividend policy.



SHARES SAYS: ↗
At first glance these acquisitions look very interesting. Keep buying. (DC)

BROKER SAYS: 6 0 0

BLACKROCK®

APPETITE FOR DISRUPTION: HOW NEW TECHNOLOGY IS DRIVING DIVIDENDS

Tony DeSpirito
Co-manager
BlackRock North American Income Trust plc

Capital at risk: All financial investments involve an element of risk. Therefore, the value of your investment and any income from it will vary and your initial investment amount cannot be guaranteed.

As much of the developed world looks forward to longer life expectancy (The Lancet, February 2017) we need to find ways to finance an extended retirement.

We anticipate that the ageing populations in the US, Europe and Japan will prioritise income in their investment portfolios. Yet just as investors need additional sources of potential income, traditional avenues are becoming less attractive or easy to find.

Faced with the 2007-08 financial crisis, central banks in much of the developed world were forced to intervene and stimulate growth, keeping interest rates at historic lows for much of the past decade. This created challenges for the fixed-income investor who used to see government bonds as a consistent source of potential income.

However, an alternative source can potentially be found in the US stock markets; more specifically, in companies that pay regular dividends to shareholders. We believe that companies responding positively to disruptive technologies – and upsetting traditional business models in the process – may prove significant as dividend payers.

Please remember that capital growth values may fluctuate and the level of income may vary from time and is not guaranteed.

Dividends for income

Traditional fixed income investors are not able to benefit from long-term growth since the yield they receive is, by definition, fixed. However, investing in shares that potentially deliver consistent dividend growth, as well as regular dividend payments, can offer investors the opportunity for long-term capital growth.

A look at the S&P 500 from 1940 to the end of 2017 reveals that dividend reinvestment and the effects of compounding (receiving interest on your interest) have accounted for more than 40% of the index's returns (Morningstar. Data from 1/1/1940 to 31/12/2017).

Please note there is no guarantee that any forecasts made will come to pass.

BlackRock®

Furthermore, there are certain sectors we believe are likely to have the potential to deliver income for investors, thanks to technological disruption.

First is technology. Many innovative start-ups offer new and exciting technologies, but well-established IT companies are also benefiting as organisations look to upgrade their systems and processes.

We're also finding that an increasing number of technology firms focused on software, networking and hardware use cash to pay dividends, contrary to the notion that IT firms can add value to investors only via their growth potential. We believe this trend will continue, as shareholders are increasingly willing to reward mature IT companies' management teams for dividend payments.

Healthcare opportunities
Improvements in life expectancy may have created challenges, but they have also created opportunities for the healthcare sector. Older populations tend to require more healthcare than younger populations (Nuffield Trust, February 2016) and healthcare spending in the US is predicted to climb 5.5% on average every year between 2017 to 2026 (Reuters, February 2018). Companies that can participate in this trend, while also improving their efficiency to counter rising costs, may be poised to benefit.

Healthcare innovators should also thrive in today's markets. The US government's Food and Drug Administration is approving more drugs and at a faster pace than before (FDA, December 2017), so pharmaceutical manufacturers that can deliver new products ultimately stand to reap the rewards.

Please note there is no guarantee that any forecasts made will come to pass.

Interest rate boost for banks
Banks are another sector of interest, although this has less to do with the increase in disruption and more to do with changing economic cycles.

Interest rates in the US are creeping back up; in March 2018 the Federal Reserve raised the target range by a quarter point to between 1.5% and 1.75% (Trading Economics, March 2018).

We believe that banks are well placed to benefit from rising short-term US interest rates. They take deposits from savers in exchange for interest payments and then lend to borrowers at a higher rate. Such a business model should translate to more profits as interest rates rise and acts as a suitable hedge against inflation for income investors. At the same time, some of the US's big banks have high levels of capital on their balance sheets which insulates them well against any market shocks.

In summary, disruptive technologies are having a real impact on our lives and not just in the way we buy groceries or order a taxi. There is also an opportunity to share in the successes of companies growing their business in disruptive markets. As such, investors looking for long-term income and growth may benefit from reviewing their portfolio and considering the impact that investing for dividends might have.

For more information on this Trust and how to access the opportunities presented by disruption, please visit **here**.

The opinions expressed are as of April 2018 and are subject to change at any time due to changes in market or economic conditions. The above descriptions are meant to be illustrative. There is no guarantee that any forecasts made will come to pass.

Risks
Please note you may not get back the amount originally invested. Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Trust specific risks: Overseas investment will be affected by movements in currency exchange rates. Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall. The Trust may use derivatives to aim to generate more income. This may reduce the potential for capital growth. Investors in this Trust should understand that capital growth is not a priority and values may fluctuate and the level of income may vary from time to time and is not guaranteed. The Trust uses derivatives as part of its investment strategy. Compared to a fund which only invests in traditional instruments such as stocks and bonds, derivatives are potentially subject to a higher level of risk.

Important Information:

BlackRock have not considered the suitability of this investment against your individual needs and risk tolerance.

To ensure you understand whether our products are suitable, please read the Key Investor Documents (KIDs) and the Annual and Half Yearly Reports available at blackrock.co.uk/its which detail more information about the risk profiles of the investments. We recommend you seek independent professional advice prior to investing.

Non-mainstream pooled investment products status.

The Company currently conducts its affairs so that its securities can be recommended by Independent Financial Advisers to ordinary retail investors in accordance with the Financial Conduct Authority (FCA) rules in relation to non-mainstream investment products and intends to continue to do so for the foreseeable future. The securities are excluded from the FCA's restrictions which apply to non-mainstream investment products because they are shares in an investment trust.

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BETTER APART: WHY COMPANY BREAK-UPS CAN RELEASE HIDDEN VALUE AND BENEFIT SHAREHOLDERS

Old Mutual, Whitbread, Prudential and Capital & Counties are set to join a growing number of companies splitting in two

Demergers are back in fashion with five companies in the FTSE 350 index each preparing to split into two separately-listed entities. Another one has just completed its split and there are rumours that a further FTSE 350 stock could spin off one of its businesses.

Unbundled companies often flourish because they have the freedom to be more entrepreneurial and not be part of a larger company where management may be more interested in other parts of the business or cannot make decisions quickly.

You also must consider the true value of a business may not have been recognised by the market when part of a larger entity.

Companies often trade at a discount to the sum of their individual parts and breaking them up via demergers can unlock this value.

Investors should take note of these events as history suggests they may be good times to invest, particularly in the company being spun out of the parent business.

WHICH COMPANIES ARE BREAKING UP?

Whitbread (WTB), **Prudential (PRU)**, **Capital & Counties (CAPC)** and **BHP Billiton (BLT)** are among the large UK-quoted companies considering demergers.

BGEO split into two businesses last month: **Bank of Georgia (BGEO)** and **Georgia Capital (CGEO)**.

Old Mutual (OML) will be the next UK-listed business to undergo this process, spinning off its UK wealth management subsidiary Quilter on 25 June. And analysts have suggested **Playtech (PTEC)**, another FTSE 350 stock, could separate its Tradetech financial division.

HOW MUCH MONEY CAN YOU MAKE?

Various bits of research demonstrate that spun-off companies tend to outperform their former owner, at least in the early days of being a standalone business.

For example, investment bank Berenberg analysed circa 1,000 European stocks that were spun-off in the past 10 years and found that they tend to outperform the market by 11% within their first year of trading.

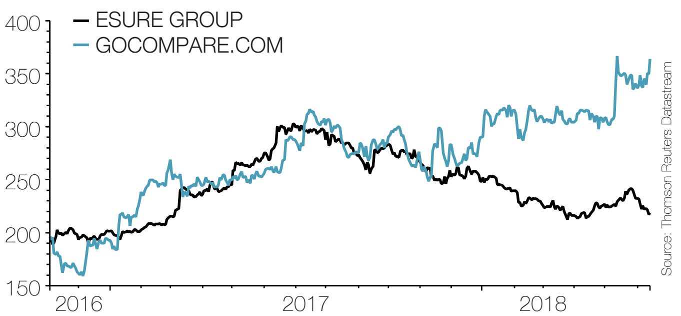
A study in 2003 by the Krannert School of Management found that subsidiaries spun out of companies outperformed their former parent by more than 20% over the first three years following the demerger; with most of the excess returns within the first 12 months of trading.

As a case in point, coal miner **South32 (S32)** was spun out of BHP Billiton in May 2015 and outperformed the latter by 6% in the first year and by four-fold over three years.

There are various exchange-traded funds which track indices of companies that have been spun out such as New York-listed VanEck Vectors Spin-Off ETF which launched three years ago. In 2016 it was up 44.7%, outperforming the S&P 500 total return index by 11.2%. So far in 2018 the ETF is up 5.6%, representing a 1.8% outperformance versus the benchmark.

TAKEOVER TARGETS?

GoCompare (GOCO) was demerged from insurer **Esure (ESUR)** in November 2016 and subsequently rose in price by 26% over the following 12 months. While impressive, it wasn't as good as Esure's 38% gain over the same period.



However, the more interesting movement has happened since its first year on the stock market. GoCompare is now up by nearly 67% since splitting from Esure versus a 13% gain from the latter.

That's mainly down to Zoopla's parent company **ZPG (ZPG)** making a takeover offer for GoCompare in November 2017.

Demerged companies can often be takeover targets. Predators find it easier to pounce on a business when it has been separated from a bigger entity rather than try and buy a company which has parts that are of no interest.

There are plenty of examples of demerged companies getting snapped up. Alent was spun out of industrials group Cookson in 2012 and bought three years later by private equity. **Greene King (GNK)** bought Spirit Pub Company in 2015, four years after it was spun out of Punch Taverns.

Both the demerged part of Cable & Wireless and its former parent company have been taken over since the telecoms group was broken up in 2010.

ARM, O2 (when known as Cellnet) and Foreign & Colonial were demerged from larger companies and subsequently acquired.

The trend stretches to other parts of the world such as in the US where Dr Pepper Snapple was spun out of Cadbury Schweppes in 2008 and a decade later received an $18.7bn takeover offer from consumer group JAB.

BENEFITS OF INVESTING IN SPIN-OFFS

Investors are increasingly asking for companies to focus on what they do best and not take a conglomerate approach with fingers in lots of pies.

It can be very hard to manage multiple businesses operating in a range of industries, hence why many companies are going down the demerger route to tighten their focus.

A demerged business can allow management to take control of their destiny and make the decisions that best serve their needs rather than a larger plc conglomerate.

They can be more entrepreneurial when they work as part of an independent company and compensation for key personnel can be more closely aligned with business objectives and performance.

There is an argument to suggest that demerged businesses tend to be better managed as the directors are responsible for their own profit and loss account, rather than working on initiatives across a wider group.

WHEN TO BUY FOLLOWING A DEMERGER

There are different strategies to play the demerger theme. The first involves the purchase of the demerged company when it starts trading on the stock market. Often the share price takes some time to get going as there will inevitably be a chunk of investors eager to sell their 'free' shares in the demerged business.

Let's create a hypothetical situation where Company X spins-off a business called Subsidiary Y. Shareholders in Company X will suddenly see they have an additional holding in their portfolio. They may see it is worth £500, for example, and think selling would effectively net them free money worth £500.

In reality the value of Company X would have fallen by £500, or thereabouts, to reflect the removal of Subsidiary Y from its interests. So, the total value of a shareholder's position in Company X and Subsidiary Y may not have changed on day one of the split.

Yet that won't be immediately apparent to everyone. You also have to consider that some investors may not want to hold the demerged business, instead preferring to keep the parent company and so they sell shares in the spun-off firm.

These decisions naturally take some time to play out, hence giving prospective investors a chance to take a position without having to worry about missing out on first-day gains that often accompany traditional stock market floats.

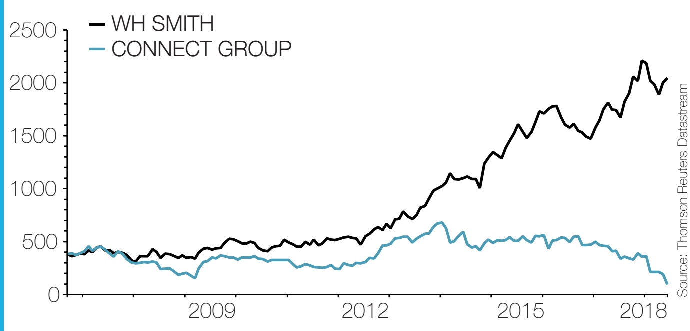
While there are studies which suggest decent gains can be made from buying demerged businesses, you must consider that past performance is not always an indicator of future returns.

SOMETIMES THE PARENT COMPANY IS THE BETTER BET

A different strategy is to buy the parent company as soon as the spin-off is declared likely or confirmed. Markets like to price in events before they happen, so you could see the value of the combined entity rise before the separation as the spin-off subsidiary is deemed to be worth more.

Investors can then decide whether they want to keep both stocks in their portfolio or just one of them.

There could be good reason for the corporate separation such as using a demerger as a way of getting rid of non-core interests or a business that doesn't have a healthy future. The slimmed down parent business could ultimately be the more attractive option for investors in this situation.



Just look at the different fortunes of **WH Smith (SMWH)** and **Connect (CNCT)** which was spun out of the former in 2006 when it was called Smiths News. At the time WH Smith said the split would let both companies benefit from increased focus on their respective strategies.

It said there were limited operational synergies and no strategic logic for keeping them together as a single business.

Fast forward 12 years and the shareholder rewards are vastly different. WH Smith has achieved a 481% share price gain since the split and Connect is down by 78% (although shareholders would have benefited from steady dividends to cushion this blow).

Connect has suffered from a core business in steady decline (newspaper and magazine distribution) and efforts to make a name for itself in the parcels delivery world haven't yielded great results, as evidenced by a horrific profit warning on 13 June this year.

DEMERGERS NOT ALWAYS RECEIVED WELL

Occasionally the market doesn't react to demerger news in the way you might expect. Shares in Puma were down by 15% at one stage upon news in January that French parent Kering would give 70% of the German sportswear group to its shareholders and focus solely on its luxury fashion and jewellery labels. Investors were disappointed that the business wouldn't be sold at a premium.

At the time of the split from Kering in May analysts at Berenberg said the demerger made Puma investable for the first time in more than a decade. They said increasing appetite by sports footwear collectors for Puma showed brand health.

They added that Puma matched the characteristics of most spin-off stocks, having been ignored by the market for years due to the relatively low amount of its shares available for public trading. It was clearly a good call as the share price has since risen by 17% in value.

HOW DO DEMERGERS WORK?

It's a fairly simple process. Typically, a company would issue a prospectus detailing the reasons behind the proposed demerger and provide in-depth information on the business.

Shareholders are then asked to vote on the demerger and, if approved, shares in the demerged entity are distributed to shareholders shortly afterwards.

Esure took less than a month from issuing a prospectus to seeing GoCompare listed on the London Stock Exchange. In comparison, Prudential's proposed break-up may take nearly two years to complete because of complicated legal and regulatory issues.

A CLOSER LOOK AT FOUR DEMERGER SITUATIONS

OLD MUTUAL / QUILTER

Old Mutual is to unbundle its UK wealth management business Quilter and list it on the London and Johannesburg stock exchanges on 25 June.

Companies normally distribute shares in the spin-off business to their shareholders like they would with cash dividend payments, but Old Mutual is going down a slightly different route. It is selling 9.5% of the business to institutional investors and distributing the rest to Old Mutual shareholders.

The distribution is structured as one Quilter share for every three shares someone holds in Old Mutual.

The demerger price is effectively being dictated by the level at which the institutions are prepared to pay for a slice of the 9.5% stake. Old Mutual has already said that the price range is between 125p and 155p each; at the midpoint Quilter would be worth £2.66bn. The final price should be confirmed on the listing day.

Old Mutual's South African shareholders account for circa 55% of the business. 'Does a South African really want to hold a UK mid cap wealth manager? Probably not in the long term,' says Oliver Brown, fund manager at **MFM UK Primary Opportunities Fund (GB00B8HGN522)**. 'They aren't natural owners for a business like this, so you could see a slow but steady drip of selling.'

Brown says there are pros and cons to the Quilter story from an investment perspective.

He views wealth management as a 'broadly attractive' industry with strong markets and increasing emphasis on individuals to save more for retirement.

However, he views it as a 'mishmash business' going through a risky IT system upgrade and a clear share overhang from the South African side of the shareholder register, and so he believes it must trade on a discount to its UK quoted peers in order to be worth an investment.

'My feeling is that Quilter should trade on 13 to 14 times forward earnings with a 3% to 3.5% yield. That would be a 25% discount to **Brewin Dolphin (BRW)**, which is the most similar company in the quoted space.

'The IT upgrade is a big issue. It has already written off a lot of money on IT work and is now getting FNZ to install a new system which is supposedly ready by the end of the year. Note that **Aviva (AV.)** and **Barclays (BARC)** both use FNZ and both encountered problems with the system when it launched.'

The bottom end of the 125p to 155p pricing range equates to a 2019 price-to-earnings ratio of 11.3-times, he adds.

> "Quilter is a Jack of all trades, master of none"

Stockbroker Numis calls Quilter a 'Jack of all trades, master of none', referring to its broad range of services. 'In trying to be all things to all people in the wealth management industry, Quilter lacks focus. As a result, we think that it will struggle to become a market-leading vertically integrated player. This does not necessarily make Quilter a bad business, just a less valuable one compared to some in our opinion.'

Numis is concerned that Quilter will miss its 30% operating margin target set for 2020. It also flags that it and five other life assurance peers are being investigated by the Financial Conduct Authority, a regulator, principally around the appropriateness of certain charges levied on long-standing customer products.

Despite these issues, Numis says wealth management is an attractive industry with long-term structural growth of 10% to 12% per year, adding: 'A rising tide lifts all ships'.

Its sum-of-the-parts valuation is 143p per share.

BGEO: BANK OF GEORGIA / GEORGIA CAPITAL

FTSE 250 financial services group BGEO last month split into two companies, Bank of Georgia and Georgia Capital. The former is expected to stay in the FTSE 250 and the latter will go in the FTSE Small Cap index.

While both companies are linked to economic activities in Georgia, there are very sensible reasons to separate the businesses and have them operate and be listed as standalone entities.

Bank of Georgia is now a pure play banking story offering exposure to a country with superior GDP growth. As a separate business it will have a more efficient capital structure and balance sheet, focusing on retail banking, wealth management, plus corporate and investment banking.

Georgia Capital is an investment business with interests in healthcare, real estate, utilities/energy, beverages, banking and insurance. 'As a separate entity, Georgia Capital would not be subject to the banking regulatory regime thereby improving its ability and flexibility to allocate capital, take advantage of various investment opportunities and better execute its growth strategy,' said BGEO ahead of the demerger.

'Georgia is a relatively small country (3.7m population) and lacks commodity wealth. However, its geographical position gives it an important strategic position, with the ability to act as a regional trading hub between Europe, Asia and the Middle East, supported by political stability and a business-friendly regime,' say the investment trust team at stockbroker Numis.

'Georgia Capital targets a minimum IRR of 25% on its investments through a focus on sectors that are expected to benefit from the continued growth and further diversification of the Georgian economy.'

Numis reckons many investors will have bought into BGEO for the banking exposure and so it wouldn't be surprised if some sold their inherited stake in Georgia Capital. However, it suggests there is potential for new investors to mop up these shares if they are interested in emerging markets and investment companies.

WHITBREAD / COSTA

Whitbread plans to demerge its Costa coffee chain by mid-2020 at the latest; most analysts expect it to happen in 2019. For the time being it will continue to invest across the group.

It recently came under pressure from activist investors which prompted the demerger news. It is unusual for a business to say it will split and give a two-year timeframe, which suggests that Whitbread was caught off guard by the presence of activists and intense speculation regarding the future of Costa.

Once Costa is listed separately, Whitbread will be left with its Premier Inn hotel assets and some restaurants. The one issue to consider is whether Whitbread gets a takeover bid for Costa – or even Premier Inn – before the demerger.

PRUDENTIAL / M&G PRUDENTIAL

Shareholders in savings and protection group Prudential will have their holding split into two separately-listed companies, both potentially qualifying for the FTSE 100 index.

Prudential is to demerge its UK operations and list them as M&G Prudential. Its remaining business will contain its faster growth US and Asian operations.

The demerger may not happen until late 2019 or early 2020 as Prudential first needs to undertake some legal paperwork.

M&G will focus on savings and retirement needs for people in the UK and Europe. It has more than 7m customers and £351bn of assets under management across 18 European markets.

The remaining business will keep the Prudential name. It has nearly 20m customers across Asia and the US. It says the working age population in Asia is growing by 1m people every month and they are under-protected, creating a huge opportunity for the business.

In the US, it believes 10,000 people will be retiring every day over the next 20 years – 'This is the wealthiest generation that has ever lived and they have a growing need for the protection products we provide,' it says. (DC)

Janus Henderson INVESTORS

Finding value in American growth

Last year saw global growth accelerate at its fastest pace since the financial crisis as this long-running bull market defied expectations and found another gear. It was a period of synchronised global growth reminiscent of yesteryear – a brief boon for global stock market investors. But with growth inevitably cooling in 2018, the challenge now is to assess where the momentum is strongest and which firms are going to thrive.

With a mandate to invest globally, The Bankers Investment Trust enjoys the privilege of buying stocks without limitations regarding market cap or geography. It is an enviable position, but it also requires a broad depth of expertise across regional markets. My job is to tie together the knowledge of seven stock pickers, each with deep regional expertise, and guide the overall weighting and direction of the portfolio. Right now, we think the US economy is on a strong footing to outperform other markets in the short- to medium-term, but we think valuations are expensive.

Given these expensive valuations, we are underweight US (27%) relative to our benchmark (51%) – the FTSE All-World Index. The Trust might be underweight US, but North America still makes up the largest geographical exposure in the portfolio, followed closely by the UK (25.4%). Therefore, we are taking a very selective approach to the US in order to capitalise on a number of macro-level drivers that we think make the US an interesting market.

US TAILWINDS

Perhaps the most eye-catching event for global investors was the approval of President Donald Trump's tax reforms towards the end of 2017, which was the first major legislative triumph for the outspoken president. It was also the country's biggest tax system overhaul in 30 years. We expect his corporate tax reductions to spur on wage growth and fuel a pick-up in consumer spending during the next 12 months.

Talk of a trade war with China might spook some investors, but I'm on the fence. I don't think a trade war between the world's two largest economies benefits either country and looks more like a push to force the Chinese to open their economy. Whether or not a 'trade war' does develop, there are some things that we are confident will keep the US on track, such as the strong domestic economy and a clear pickup in capital expenditure. This growth may be dampened by further US interest rate rises but I expect the Fed to stay behind the curve by limiting the number of interest rate rises this year.

Another positive for the US is the recent revival of the dollar. Since the lows of 2012, the trade-weighted dollar (against a basket of currencies) has appreciated by almost 40%, albeit in 2017 it weakened against most currencies. There are longer-term concerns about the country's national deficit rising, but it's not something to worry too much about now and as growth picks up around the world the deficit could naturally decline.

A HOLD FOREVER APPROACH

Broadly speaking, the valuation of the US stock market appears elevated on most measures relative to its history. Our North American team remain very conscious of this and continue to abide by a strict valuation discipline. Although they operate with a "hold forever" mind-set, meaning each company is bought with a view to owning into perpetuity, each holding must demonstrate sufficient upside over the next five years to earn a place in the North American portfolio. The aim is to create a portfolio of undervalued companies which enjoy a sustainable competitive advantage and operate in structurally growing end markets.

The majority of the portfolio is tied to the following five long-term secular trends, which the team believe to be underappreciated by the wider market; the transformational effect of the internet, healthcare innovation, paperless payments, energy efficiency and emerging market growth.

Take healthcare innovation, which is important given America's ageing demographic – the country's population aged 65-and-over reached 50 million for the first time in 2016 and is expected to continue growing as the 'baby boomers' reach retirement. Considering this, we look for companies that aim to provide solutions to the challenges brought on by an ageing population. For example, California-based contact lens manufacturer The Cooper Companies is a stock we like because one of its revenue drivers stems from the growth in multifocal lenses, which are widely amenable to an ageing population.

Given the relative expensiveness of US equities, we have sold more than we have bought in recent months. The additions we have made to the portfolio come from a diverse range of sectors but importantly all share a common feature: a sustainable competitive advantage, which allows for reinvestment at a high rate of return. Some of our recent additions include luxury cosmetics manufacturer Estee Lauder, computer gaming company Electronic Arts, freight hauling railroad Union Pacific and software giant Microsoft, which is a rarity in the tech sector for its 2% dividend.

EMERGING MARKET PROXIES

Our North American exposure is well diversified across sectors with technology (c. 24%) and financials (c. 21%) afforded the largest allocations. That said, the financials exposure is potentially misleading as most of us think of banks and insurers when we say financials, but much of our exposure to the financial sector consists of electronic payment institutions like MasterCard and American Express, and conglomerates like Warren Buffett's Berkshire Hathaway, for example. These companies are positively involved in the long-term socioeconomic trends, particularly the transition to paperless payments.

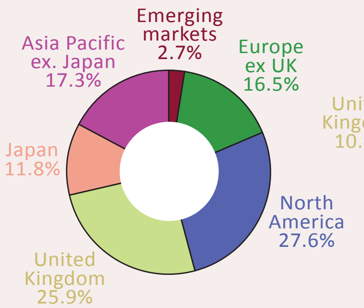
The trends we refer to are not specific to the US or North America, but the region is typically at the forefront of innovation – perhaps only rivalled now by Asia's growing technology sector. One of the key trends that guide our stock selection is emerging market growth. This is most easily demonstrated in the chart on the right, which shows that although North American stocks account for the largest geographical weighting (27.6%), the companies in the portfolio generate most of their revenues from emerging markets (30.1%).

We could invest directly in to emerging markets – and we do, albeit with only 2.4% of the portfolio – but I like to invest in companies listed in developed markets because they typically have higher quality accounting, audits, governance and lower leverage on the balance sheet. We look for firms in developed markets that have strong business operations in emerging markets, where consumer spending is expanding at a rate only possible with a growing middle class.

The Bankers portfolio will continue to look globally for quality companies with strong drivers in place for future earnings growth but will continue to maintain a strict discipline in terms of the share prices we are willing to pay.

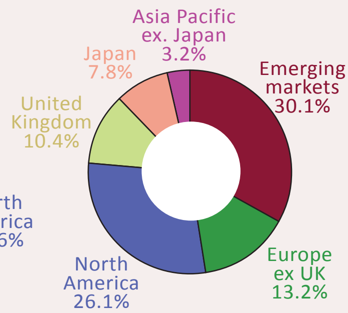
GEOGRAPHIC BREAKDOWN

By listing location



Source: Janus Henderson Investors, as at 31 March 2018.
Note: Reweighted to exclude cash. Totals may not equal 100 due to rounding.

By revenue generated



Source: Janus Henderson Investors, as at 31 March 2018.
Note: Totals may not equal 100 due to rounding.

GLOSSARY

- Bull market: A financial market in which the prices of securities are rising, especially over a long time. The opposite of a bear market.
- Underweight: To hold a lower weighting of an individual security, asset class, sector, or geographical region than a portfolio's benchmark.
- Secular trends: An economy or market trend associated with some characteristic or phenomenon that is not cyclical or seasonal but exists over a relatively long period.
- Emerging market proxies: Securities that derive performance from emerging markets.

Promising early signs from rebooted investment trust

Aberdeen Diversified Income and Growth has done well in a fairly hostile environment helped by its diversification

The first set of results to include a full 12 months' trading since the merger of BlackRock Income Strategies Trust and Aberdeen UK Tracker make for positive reading at **Aberdeen Diversified Income and Growth (ADIG)**.

The trust was launched in its current format in February 2017 and the latest results show 8% total return to shareholders for the year to 31 March 2018.

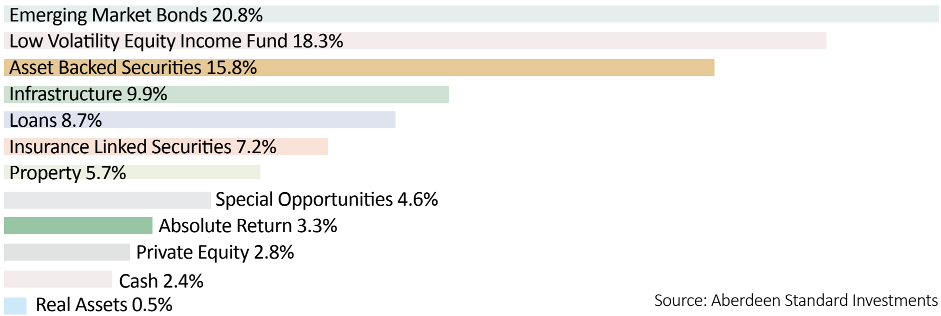
It aims to deliver a return of Libor +5.5% after fees over rolling five year periods. The latest result is clearly in line with its stated objective as libor plus 5.5% net of fees over the last 12 months is equivalent to a return of 6% according to the trust's chairman James Long.

Investors should be happy with the performance for two reasons. First, it compares favourably to the various benchmarks the trust tracks due to its variety of assets.

Global equities, represented by the MSCI All Country World Index, returned 1.8%; UK equities reflected by the FTSE All Share Index returned 1.3%; while UK bonds shown by the FTA UK Conventional Gilts All Stocks Index made 0.5%.

Second, it vindicates the decision in 2016 to sack BlackRock as the manager after a year and a half in charge and bring in Aberdeen. BlackRock had been hired to revive the product originally known as British Assets Trust but failed to deliver a decent performance.

ASSET ALLOCATION



Source: Aberdeen Standard Investments

It is worth noting the 8% total return over the past 12 months was helped by a narrowing of the discount to net asset value (NAV). NAV on its own rose by 4.5% on a total return basis so there is still some work to do in order to hit the performance goal.

The investment trust is led by two veteran managers, Mike Brooks and Tony Foster, who have a lot of experience across a broad range of asset classes.

The use of a variety of asset types is a well-established method of keeping volatility down in the fund and was a key part of the portfolio reorganisation when the new management took over.

The switch to Aberdeen saw the dividend cut by 20% to an annual rate of at least 5.2p per share, which equates to a dividend yield of 4.3% based on the current share price of 122p. At the half year stage, it had declared 2.62p in dividends.

In February, investment trust analyst Innes Urquhart at financial services group Winterflood said Aberdeen Diversified Income and Growth was a 'considerably more attractive proposition than it was in its previous guise'.

The analyst said it was too early to judge the performance and that the real test would be in more difficult market conditions. (DS)

Power price declines put renewable trusts under pressure

Stifel explains its 'sell' ratings on NextEnergy Solar and John Laing Environmental Assets

The spotlight has fallen on infrastructure investment trusts after two separate closed-end funds have come under fire from analysts at investment bank Stifel.

It is negative on the immediate prospects for **NextEnergy Solar Fund (NESF)** and **John Laing Environmental Assets (JLEN)** largely because of declining power price assumptions that act as a drag on net asset value (NAV).

Long-term power price assumptions have fallen by 7.7% on 25 year forecasts, according to one electricity consultant, say Stifel's investment trust team.

NextEnergy saw its full year to 31 March 2019 power price predictions cut by nearly 10%, versus a 5.2% decline at the half year stage.

Factors such as sterling depreciation, US dollar-denominated gas prices decreasing and a reduction in the marginal cost of capital for renewables have combined to work against assumptions being made about future power prices.

This capped NAV progress for both trusts in the last financial year. John Laing's NAV for the financial year to 31 March 2018 was reported at 99.6p per share, just 1.1% higher than the 98.5p per share 12 months earlier.

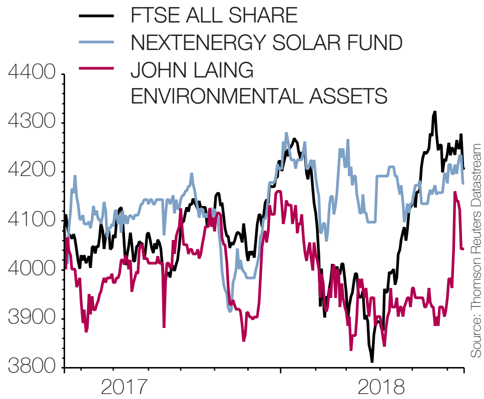
NextEnergy's NAV stayed virtually flat during its full year, edging down from 104.9p to 104.7p. This result has sparked Stifel to call into question current 6% to 7% share price to NAV premiums, particularly given the likelihood that new shares will be issued in the future, presumably to provide acquisition funding.

'We would be more comfortable with this fund and the rest of the renewables sector trading on a small single-digit premium given the likelihood of ongoing equity issuance,' say Stifel's Iain Scouller and Anthony Stern.

The analysts are also concerned about skinny dividend cover at NextEnergy this year, which they calculate at 1.05-times. NextEnergy paid four quarterly dividends last year totalling 6.42p per share and management have spelled out a target of 6.65p per share in shareholder payouts this year.

John Laing's 6.31p per share dividend last year was covered just 1.1-times according to calculations based on Stifel's declared dividend measure. The trust anticipates upping the payout this year by 3.2% to 6.51p per share, implying a 6.35% income yield.

Stifel makes the point that new equity funds are typically raised at a small discount to prevailing share prices. This implies, they say, that there will be 'better entry points than the current market price.' (SF)



JO Hambro fund celebrates a decade of dynamism

JOHCM UK Dynamic continues to profit from positive corporate change

'I am higher conviction than I've ever been on how we add value, why we do what we do, how it works and why it works,' says Alex Savvides, senior fund manager of his brainchild product, the **JOHCM UK Dynamic Fund (GB00B4T7HR59)**.

This collective seeks to profit by backing positive corporate change and offer investors a compelling combination of recovery situations, and restructuring and 'hidden growth' stories.

Launched on 16 June 2008 in the teeth of the financial crisis, the fund has just celebrated its 10 year anniversary and has proved an impressive performer.

Trustnet's five year cumulative performance data shows the fund up 77.3% versus a 57.1% gain for the IA UK All Companies sector.

Savvides believes the market's misunderstanding of corporate change – typically new management teams with new strategies – regularly throws up opportunities for patient, disciplined and unemotional investors.

His process aims to profit from understanding change and investing where there is the highest probability of success but with the highest cash-based valuation support. This approach typically leads him to put money to work with high quality, unloved and under-researched UK companies, often in out-of-favour areas of the market.

ADDING VALUE

Following an extended bull market run, finding stocks at rock bottom valuations is more of a challenge, yet Savvides insists: 'There are always opportunities to invest in companies where management teams have been underperforming relative to the capabilities of those companies and I think that is genuinely stock market and economic cycle agnostic.'

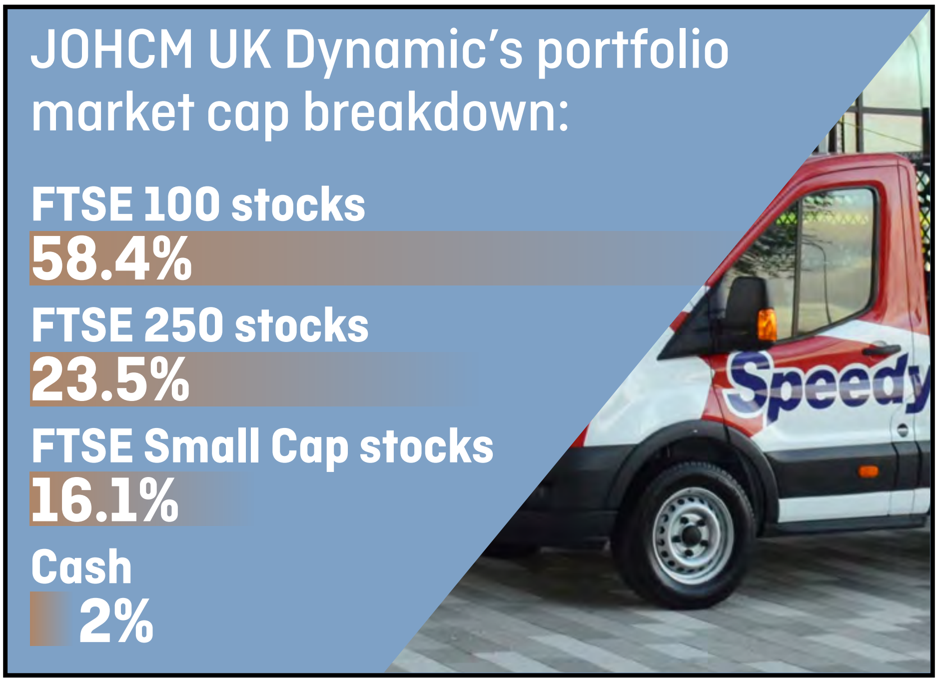
The independent thinker's fund contains 45 carefully selected holdings ranging from private equity giant **3i (III)** and oil major **BP (BP.)** to distributor **Electrocomponents (ECM)**.

'There are always companies trading in their own little lifecycle, their own little general economic cycle and therefore there is always going to be some raw material for us. Having said that, it is always easier for us when the general level of everything is cheaper and you usually get those situations nearer to low points of cycles.

'We are somewhere in the other direction at the moment but a big portion of our return has always been delivered by the self-help element within stocks.'

Savvides stresses he never invests without meeting management teams and is

The fund's carefully selected holdings include oil major BP



highly selective over the people he'll back.

'Our whole process is about backing an essentially good asset that is underperforming with an essentially good management team that get it in terms of knowing the value of a pound and knowing simplistic things like return on equity without having to work it out on a spreadsheet,' he explains. 'Marrying up good management with an interesting stock situation is what makes this process work.'

CONTRARIAN CALL

Despite current high political risk, Savvides is much more constructive around the UK than he has been for a long time. The fund has roughly a third of its assets in UK-facing stocks, up from circa 20% going into Brexit.

Savvides says attitudes towards the UK economy broadly have been 'too negative'; the delivery of a 'reasonable' Brexit deal could brighten the overall picture and the real wage squeeze is ending.

Last year, JOHCM UK Dynamic Fund added to names which had suffered following the uncertainty engendered by the snap general election, among them **Restaurant Group (RTN)** where Savvides thinks negative sentiment linked to the *Frankie & Benny's* brand is now outdated. The fund also beefed up holdings in grocer **WM Morrison Supermarkets (MRW)** and defence specialist **QinetiQ (QQ.)**.

Other additions included **Tesco (TSCO)**, **Daily Mail & General Trust (DMGT)** and tool hire firm **Speedy Hire (SDY)**, whose new management team continues to reduce the size of its hire fleet while increasing return on capital employed, a measure of how effectively a company reinvests cash back into its business to generate additional returns.

Savvides notes Speedy Hire's return on capital is now higher than its cost of capital 'for the first time in a generation'. He says the business has invested that capital in parts of the industry that are growing, such as testing, inspection and powered access.

DMGT DELIGHT

The savvy Savvides invested in consumer media-to-business information group DMGT about a year ago and dubs the company 'a fascinating situation', with a new Lord Rothermere (DMGT chairman)-backed CEO and FD – Paul Zwillenberg & Tim Collier respectively – having 'instigated a process of radical change across the organisation'.

DMGT's stake in **Euromoney (ERM)** has been reduced, US property asset EDR sold and the sale of the company's 30% stake in **ZPG (ZPG)** to Silver Lake should bring in another £640m of proceeds. 'DMGT will have to invest it, but I think they'll invest it wisely or they'll return cash to shareholders,' enthuses Savvides. 'To me, that represents everything that is good about change investing.

'I now have to have belief this management team will allocate capital correctly. There is nothing this team has done since they've become chief executive and finance director of DMGT that leads me to believe they'll take poor decisions,' he concludes. (JC)

JOHCM UK DYNAMIC FUND: TOP 10 HOLDINGS

BP	6.2%
Shell	5.9%
GSK	5.0%
HSBC	4.9%
Morrisons	4.1%
Lloyds Banking	4.0%
3i	4.0%
Aviva	3.8%
Vodafone	3.8%
Electrocomponents	3.8%

Source: JOHCM, as at 30 April 2018

Oils and banks remain the key to FTSE 100's momentum

Pharma/healthcare and miners are also important to the direction of the blue chip UK stock market index

After ending 2017 on a hot streak the FTSE 100 is finding the going tougher in 2018. Although it stands within touching distance of the all-time high reached in May, the benchmark index can point to a capital return of barely 1% as the first half of this year draws to a close.

SPRING RALLY LEAVES FTSE 100 NEAR ITS ALL-TIME HIGHS

Source: Thomson Reuters Datastream

This naturally begs the question of whether the index can find fresh momentum in the second half and if so why – and if not, then why not?

To get a better understanding of this situation it is necessary to look at the index's make-up and which sectors and stocks wield the greatest influence, both in terms of their market capitalisation and their contribution to the benchmark's aggregate profits and dividend payments.

This issue of mix will have a great say in how the FTSE 100 may perform in 2018 and beyond. Investors need to keep their eyes on just four groupings of stocks, as they dominate analysts' consensus forecasts for profits and profit growth, and they are the most likely drivers of capital returns. They are (in alphabetical order):

- Financials (namely banks and insurance, both life and non-life)
- Pharmaceuticals/Healthcare
- Miners (whose profit contribution is relatively

FOUR SECTORS DOMINATE FTSE 100 EARNINGS AND PROFITS GROWTH FORECASTS IN 2018			
2018		2018	
FORECAST PROFIT CONTRIBUTION		FORECAST PROFIT GROWTH CONTRIBUTION	
Financials	24%	Oil & Gas	32%
Oil & Gas	17%	Financials	23%
Mining	16%	Health Care	14%
Consumer Staples	13%	Consumer Staples	11%
Consumer Discretionary	10%	Consumer Discretionary	8%
Industrial Goods & Services	7%	Mining	6%
Health Care	7%	Industrial Goods & Services	3%
Telecoms	3%	Utilities	2%
Utilities	3%	Technology	1%
Technology	0%	Telecoms	1%
Real Estate	0%	Real Estate	0%

Source: Digital Look, company accounts, aggregate consensus analysts' estimates

modest but whose rapid rebound means the sector is forecast to provide a big chunk of profit growth)

- Oil and Gas Producers

An aggregate of bottom-up analyst consensus forecasts shows this quartet is expected to generate roughly two-thirds of the index's total profit and three-quarters of its profit growth this year.

FOUR AGAINST THE FIELD

For the moment, two of these sectors can be seen in a positive light, although one is now facing greater challenges. One seems set fair but has yet to convince, judging by recent share price performance, while one has been a perennial disappointment of late.

- **Going well – Oils and miners**

The big oil stocks have understandably been boosted by a surge in the oil price to $80 as OPEC and Russia have surprised many by sticking to the production cuts first outlined in December 2016.

The question now is whether Saudi Arabia and Russia start to push for higher output now, to the potential detriment of the oil price and **BP (BP.)** and **Royal Dutch Shell's (RDSB)** earnings momentum, although income hunters will be pleased to see how a higher crude price means their dividend payments are better underpinned.

The miners continue to see earnings upgrades, at least when it comes to industrial metals and coal. Gold and silver prices seem largely becalmed for the moment, with copper barging through the $7,000 per tonne mark, helped by talk of strikes in Chile in particular.

Whether their highly cyclical revenue streams can be entirely relied upon is open to question but if the market narrative of a 'synchronous global upturn' holds good, then the UK stock market could benefit from its exposure to miners.

- **Could be doing better: the banks**

This is an odd one. In theory, conditions look primed for better performance from the banks, as equity markets rise, merger and acquisition activity booms, debt and mortgage delinquencies remain low, regulatory woes start to fade into the background and the lenders reap the benefits of their cost-cutting programmes.

Yet the sector worldwide is struggling and the UK's Big Five have lost share price momentum to suggest investors remain sceptical of bullish profit forecasts.

- **Pharma: questions to answer**

In theory, the pharmaceuticals/healthcare combination is due to almost double its pre-tax profit to £16bn in 2018, generating almost one seventh of total FTSE 100 earnings growth for the year.

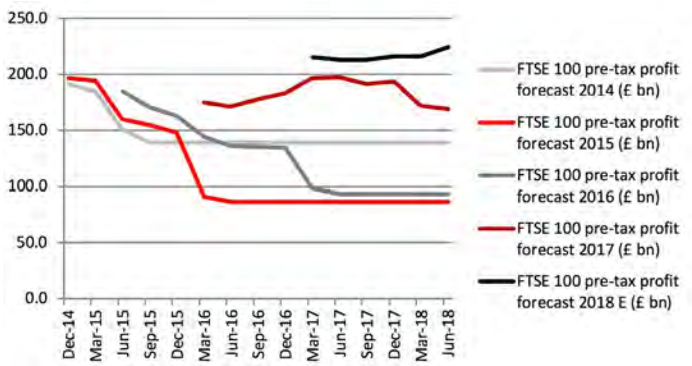
Yet much of the estimated uptick is due to come from **AstraZeneca (AZN)** and **GlaxoSmithKline (GSK)** and is as much to do with lower exceptional charges and restructuring costs as with new drug releases and powerful pipelines. We've heard this story before and neither firm has delivered so far.

FEEL THE WIDTH

For all of such doubts, the good news is that aggregate earnings forecasts for the FTSE 100 are rising again, as the pound weakens (thanks to the Bank of England), oil and metal prices point to gains on the year, and companies with US exposure have begun to see the benefits of the Trump tax cuts.

This absence of net profit downgrades compares favourably to 2014, 2015, 2016 and also 2017 right at the end.

FTSE 100 EARNINGS ESTIMATES ARE MOVING HIGHER AGAIN

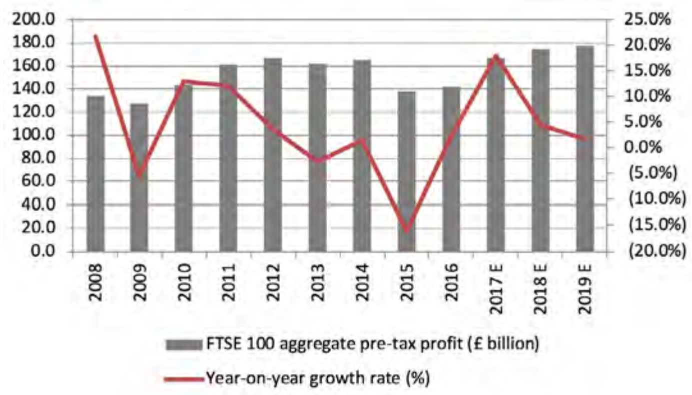


Source: Digital Look, company accounts, aggregate consensus analysts' estimates

At least investors now know which sectors need to do the business to keep that trend going. If oils, miners, banks and healthcare stocks find trouble, then the FTSE 100 may well do the same.

Further commodity price gains, a clean regulatory bill of health for the banks and improved earnings from the big drug plays could herald that long-awaited push to 8,000 and beyond.

FTSE 100 EARNINGS ARE SEEN REACHING RECORD LEVELS IN 2018

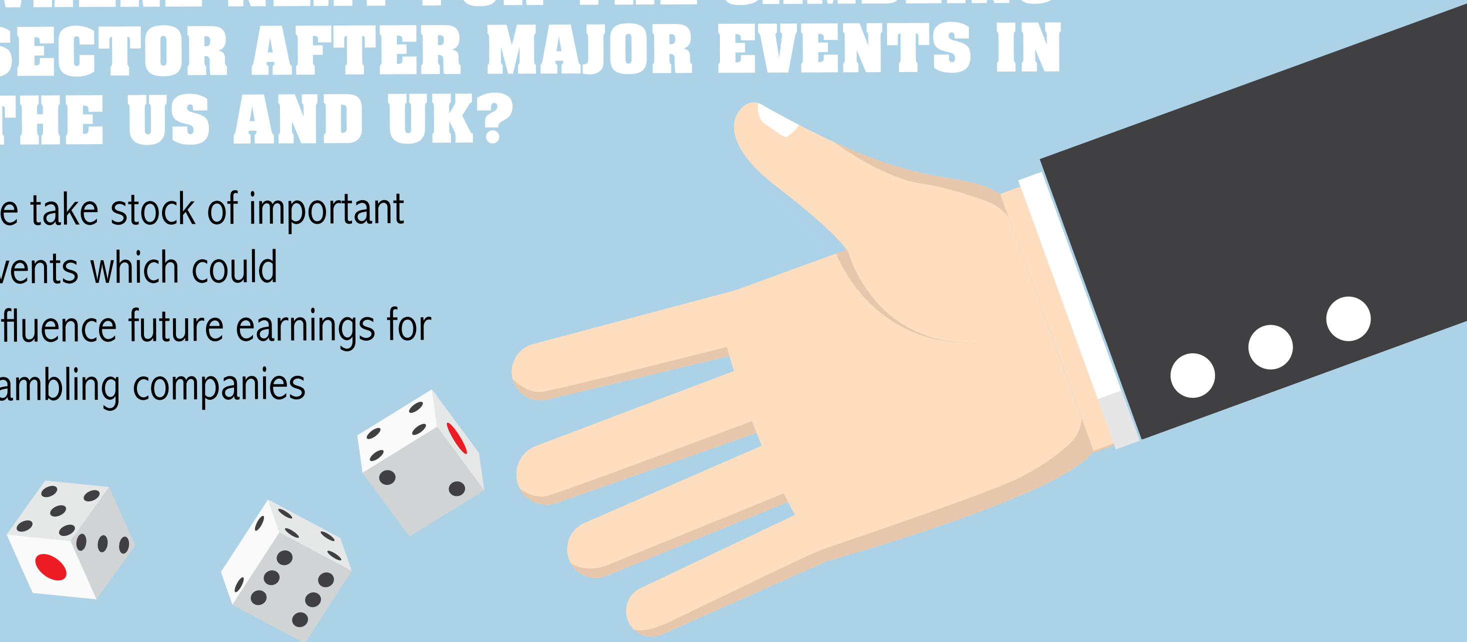


Source: Digital Look, company accounts, aggregate consensus analysts' estimates

By Russ Mould, investment director, AJ Bell

WHERE NEXT FOR THE GAMBLING SECTOR AFTER MAJOR EVENTS IN THE US AND UK?

We take stock of important events which could influence future earnings for gambling companies



The gambling sector has this year experienced a mixture of very good and very bad news, prompting wild share price movements.

Now is an opportune time to take stock of the sector, particularly as share prices have had time to price in forthcoming changes to the UK fixed-odds betting terminals market and the hype has died down about the opening up of the US sports betting industry.

The latter event is now the primary focus of investors as a legal sports betting market could eventually be worth up to $9bn in gross gaming revenues, according to forecasts by gaming consultant Global Market Advisors.

In May, the Supreme Court decided to repeal the Professional and Amateur Sports Protection Act (PASPA) of 1992, essentially allowing individual states to legalise sports betting.

The US may now be the land of opportunity for the gambling sector yet investors should note that legalising sports betting in individual states will take time.

TAXES AND FEES

One of the biggest issues is the potential impact of taxes and licensing fees as they can be a huge and render the market opportunity unattractive for operators.

For example, New Jersey has a tax rate of 8.5% on sports betting wagers but Pennsylvania is considering a 36% tax rate. Potentially high start-up costs could add to gambling operators' financial burden, making it difficult for them to breakeven.

While some states are steamrolling ahead with legislation, political opposition could slow down progress. This is evident in Missouri, Oklahoma and Louisiana after failing to enact a sports betting bill in May.

Fortunately these setbacks have not deterred other states. Mississippi, Pennsylvania, West Virginia, Illinois, New York and Rhode Island are hoping to make progress with some potentially offering sports betting in a few weeks' time according to investment bank Berenberg.

Every state has its own timetable, regulatory framework and each could face different competitive pressures.

WHY PATIENCE IS NEEDED

Michael Campbell, an analyst at stockbroker Whitman Howard, believes the market potential, which could be worth $6bn in gaming revenue in around five years' time, will take some time to develop as operators prepare to get up and running pending state-by-state legislation.

Based on 22 states where daily fantasy sports is currently legal, Campbell argues this may be a reasonable guide for how many states would potentially legalise traditional sports betting, which could limit the overall market potential.

By 2020, he tentatively forecasts between 15 and 20 states may have legalised sports betting.

The analyst is wary of punitive taxes and integrity fees as this could deter operators which may be forced to offer odds on sports events to customers which are not as competitive as odds from unlicensed betting operators.

At least $150bn a year is wagered illegally on sports betting according to the American Gaming Association. Illegal sports betting is unlikely to stop, says Campbell, but legal means could appeal to gamblers due to regulation and consumer protection.

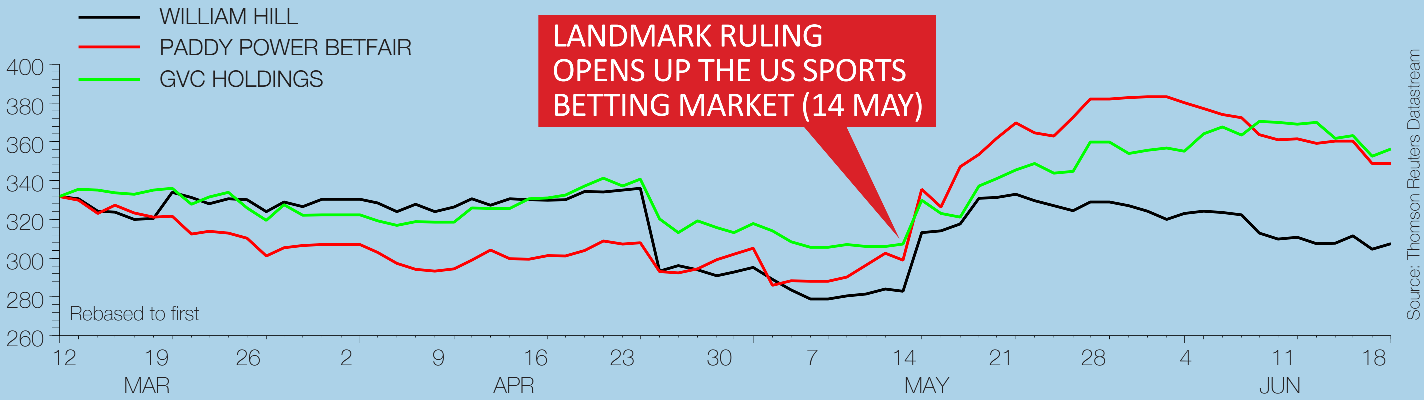
HOW DO UK-LISTED GAMBLING COMPANIES FIT INTO THE EQUATION?

It has barely been a month since the historic sports betting decision yet there are a deluge of deals emerging as **Paddy Power Betfair (PPB), GVC (GVC)** and **William Hill (WMH)** plan to take advantage of liberalised gamblers.

Paddy Power Betfair recently sealed a deal to combine its US business with fantasy sports operator FanDuel to take advantage of its strong brand and large customer base. The gambling firm will own 61% of merged business, increasing to 80% after three years and full ownership in five years.

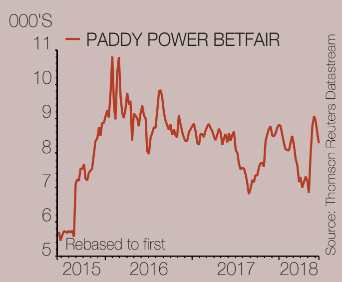
Deals have also been secured with Meadowlands racetrack in New Jersey and Tiago Downs casino in New York.

Davy Research analyst David Jennings says these states are two of the 'best prospective markets in the US' as they are likely to be among the first to regulate sports betting and may benefit from low tax rates.



PADDY POWER

Paddy Power Betfair has soared by over $2bn in market value since the US sports betting breakthrough in May.



'In reality, whether the US opportunity is worth that much today depends entirely on how patient investors are willing to be on the US front,' comments Jennings at Davy.

He says without US sports betting or further M&A, the company is unlikely to materially grow earnings between now and 2020 due to the impact of gaming taxes and regulatory changes.

WILLIAM HILL

William Hill has operated in Nevada since 2011 through its US division. It is planning to grow its US presence by operating sports books for Ocean Resort casino and Monmouth Park racetrack in New Jersey.

The move is a sensible one as New Jersey is one of the biggest states so far to sign the bill into law.

GVC

There have been no tie-ups yet from GVC although the gambling company's sports betting platform operated by its subsidiary Stadium Technology will be used to accept single-game sports bets in Delaware casinos.

GVC already has a relationship with MCM for online casino games in New Jersey.

Berenberg analyst Robert Ciaccia is confident there is significant upside for GVC's share price even if the business does not fully take advantage of the US opportunity, which he argues is not factored into the share price at all.

The analyst highlights the strong management team, diverse geographic exposure and cash-generative nature of the business, as well as synergies from the recent acquisition of Ladbrokes Coral.

Ciaccia says synergies from the Ladbrokes deal could be significantly higher than the anticipated £100m and potentially double that level if revenue and capital expenditure are included.

COULD M&A BE ON THE CARDS?

There has been a lot of speculation over potential consolidation in the sector since the opening up of the US sports betting market.

William Hill is seen as the prime choice for a takeover target among UK-listed gambling companies after suffering myriad problems. Over the past five years, shares in William Hill have fallen by more than 30% to 310.5p.

AJ Bell investment director Russ Mould believes William Hill didn't adapt quickly enough to meet the shift to online gambling, unlike its faster rivals.

This led to online boss James Henderson losing his job in 2016 after the new sports betting platform Project Trafalgar encountered teething troubles in 2015.

'William Hill lost vital ground during this period as more digitally aware rivals took share and also gained ground through strategic mergers and acquisitions,' comments Mould.

OTHER STRATEGIC HICCUPS

The company's attempt to enter Australia via the acquisition of assets from Sportingbet in 2013 also failed to pan out due to regulatory changes. William Hill sold the business at a loss this year to CrownBet, which is owned by Stars Group.

Another opportunistic target could be **Sportech (SPO)**, despite it previously being put up for sale and not attracting any decent offers for the business.

Whitman Howard's Michael Campbell says Sportech is among the best positioned in the US thanks to its footprint in Connecticut; its Quantum system, which supplies wagering software to customers in 37 states; and a recent deal with Sportradar to supply a fixed odds sports betting book.

Berenberg throws cold water on any US-related M&A speculation for the industry, highlighting it is too early for operators to assess the sports betting opportunity and commit funds for consolidation.

PRE-TAX PROFIT FORECASTS

	2018	2019	2020
GVC	£542.6M	£628.4M	£577.6M
PADDY POWER BETFAIR	£366.6M	£408M	£466.2M
WILLIAM HILL	£252.8M	£259.1M	£179M

For the year to 31 December
Source: Reuters Eikon

WHAT ABOUT THE REGULATORY PRESSURES IN THE UK?

The Government's drive to reduce dangerous losses for problem gamblers has had a major impact on several UK-quoted companies.

Initially, the sector was hoping a cut to the maximum stake on fixed-odds betting terminals (FOBTs) would not be too extensive, but were proved wrong earlier this year.

Instead of the maximum stake being cut from £100 to £30 or below, it was slashed to £2 a spin and threatened a vital source of profitability.

William Hill has warned the new limit could hit total gaming net revenue by 35% to 45% and says 900 of its shops could become loss-making and potentially close.

For rival Paddy Power, the impact is expected to be slightly lower but still significant with an anticipated decline in a range of 33% to 34% in machine gaming revenue. This equates to approximately 2% to 2.6% of overall sales.

In light of the review, GVC anticipates a £160m impact on earnings before interest, tax, depreciation and amortisation in the first full financial year. There are reports the switch to the lower betting limit may take until April 2020 to be implemented.

KNOCK-ON IMPACT

It is widely expected that the Government will make other changes to the sector in order to recoup the lost tax from changing the FOBT betting limits. This could see a higher point of consumption tax which is a tax on bets placed online by individuals based in the UK.

Berenberg forecasts the point of consumption tax will rise from 15% to 20% from January 2020. This would cause another squeeze on industry profit, thus putting pressure on management teams to diversify their earnings away from the UK as much as possible.

SHARES SAYS:
Our top sector pick is GVC because of its scale, broad geographic reach, online expertise, strong brands and sizeable integration synergies potential. (LMJ)

How to avoid the buy-to-let crackdown

We look at some of the new hurdles for investors in this market and how to mitigate them

The buy-to-let sector has faced a crackdown in recent years, with successive Government policies making it harder for landlords to make a profit. Particularly hit are so-called 'dinner party' landlords, who have one or two rental properties.

In the past two years the Government has increased stamp duty rates for buy-to-let investors, cut the tax relief available for landlords and made the borrowing criteria applied by mortgage companies stricter for some landlords.

Figures from mortgage lender industry body IMLA already show a significant impact with an 80% fall in new lending for buy-to-let properties between 2015 and 2017.

Here we look at the hurdles, and the ways investors can overcome them.

HURDLE ONE: TOUGHER MORTGAGE LENDING

Last year the regulator toughened up the criteria on which mortgage companies determine their lending. Put plainly, this means the amount of rent you have coming in from buy-to-let must be a higher proportion of your mortgage costs than before.

A good rule of thumb is that you need your rent to cover between 125% and 145% of the mortgage payments each month.

The 'stress rate', which is the interest rate used to measure borrowing affordability, has also increased to 5.5% in some cases – a further crunch on how much you can borrow.

The rules are even stricter for 'portfolio landlords', those with four or more properties. New rules introduced in October last year mean that when portfolio landlords apply to remortgage, the finances on all their properties must be taken into consideration. This is more of an administration headache for investors, particularly those with very large portfolios.

HOW TO FIX IT?

The rules mean more people need their rent to cover 145% of their mortgage costs, but lenders are flexible in certain circumstances, says David Hollingworth, of mortgage broker London and Country.

The rental coverage required is likely to be lower for those fixing their mortgage for a longer term, borrowing less relative to the property's value, owning the property in a limited company and for basic-rate taxpayers.

For example, the Mortgage Works, a lender, only requires 125% rental cover for a 20% tax payer, but 145% cover if you're a higher rate or additional rate payer.

Also with the Mortgage Works, someone borrowing 35% of the value would be stress tested at an interest rate of 4.99%, while someone borrowing a higher percentage would be tested at 5.5%.

Hollingworth says: 'More

landlords are going for longer term fixed rates, whether that is down to the potential for rate rises, or lenders offering a preferential interest coverage ratio for longer term fixes, or for portfolio landlords to avoid going through the admin headache so often.'

HURDLE TWO: SCRAPPED TAX BREAKS

From April last year a valuable tax relief for buy-to-let investors started to be phased out. The Government is removing the ability for landlords to deduct mortgage interest from their rental income, before working out the tax owed. The perk is being scrapped by 25% for each year, until 2020 when it will be eliminated entirely. It will be replaced with a 20% tax credit.

This means that currently landlords can claim 50% of their mortgage interest against their rental income, while next tax year they can claim just 25%.

HOW TO FIX IT?

Basic-rate taxpayers may not be affected by the change. The 20% tax credit applied by the Government means the move is cost neutral for these individuals.

It is possible for those in the higher-rate tax bracket to bring themselves into the 20% basic rate tax band by making larger pension contributions. These individuals need to be able to spare the additional cash, but saving money into a pension reduces your salary for income tax purposes.

This means if you make additional contributions to your company pension or self-invested personal pension you could bring your income below £46,350, and so become a basic-rate taxpayer.

If this isn't possible, now more than ever it's important to cut the amount of mortgage interest you're paying, and to make the property as profitable as possible.

This means a number of landlords are remortgaging onto lower rates.

A small number of landlords are also shifting their mortgage debt from their buy-to-let property to their main home. This is because rates on borrowing on your own home are lower than buy-to-let properties, and so profitability is boosted. However, you will need to have enough income to meet the mortgage affordability criteria, and have enough equity in your property. Seeking

BUY-TO-LET MORTGAGE INTEREST RELIEF CHANGES

Assuming someone with rental income of £1,500 a month and interest-only mortgage costs of £1,000 a month, and that the landlord is a 40% taxpayer.

Before the changes		**In 2020/21**	
Rent	£18,000	Rent	£18,000
Mortgage interest	£12,000	Mortgage interest	£12,000
Taxable profit	£6,000	Taxable profit	£18,000
Tax due (at 40%)	£2,400	Tax due (at 40%)	£7,200
Net profit after tax	£3,600	Less 20% tax credit	-£2,400
		Tax due	£4,800
		Net profit after tax	£1,200

the help of a tax adviser or accountant is advisable here.

Another way to avoid the crunch is to own the properties within a limited company, as the crackdown does not apply here.

However, there are drawbacks to using a limited company. There are (relatively low) set-up costs and you'll need to file an annual return, which may require an accountant. There are still corporation taxes to pay, and dividend taxes when taking income out of the company.

Existing property owners may consider moving their portfolio into a company structure, however, this requires selling the properties and effectively re-buying them inside the company, which may result in capital gains tax and stamp duty bills.

The biggest drawback is that the cost of borrowing within a company structure, compared to doing so individually, is higher. This means any mortgage debt will have a higher interest rate.

Whether it is beneficial to set up a company depends on a number of factors, including the number of properties owned, the income of the investor, and the level of mortgage debt. A tax adviser's help should be sought.

HURDLE THREE: THE STAMP DUTY SURCHARGE

From April 2016 anyone buying a second home above the value of £40,000 has to pay an additional three percentage points in stamp duty on the purchase.

The rules are complicated, but broadly speaking, if you are not replacing your main residence, you will have to pay the surcharge.

On the average UK property price of £220,000, someone buying a second (or third, or fourth) property will pay £8,500 in stamp duty, compared to £1,900 under the previous system. For a £500,000 home the stamp duty will now be £30,000, compared to £15,000 before April 2016.

HOW TO FIX IT?

There are very few ways to avoid paying this surcharge. You can buy properties under £40,000, as below this threshold the surcharge does not apply. In many areas of the country none will exist at this price, so you may end up buying far away from where you live – which will come with additional costs of getting someone else to manage the buy-to-let.

You also do not pay the surcharge on caravans, mobile homes and houseboats.

Another option is to buy commercial property, as the surcharge does not apply here. This can seem daunting for some novice buy-to-let investors, but mixed-use properties such as a shop with a flat above can be a good place to start.

In the same £500,000 example above, the stamp duty due on a commercial property would be £14,500. No stamp duty is due on the first £150,000 of a commercial property, with 2% due on the tranche from £150,000 to £250,000, and 5% due on any amount above this.

Yields are often higher on commercial properties, and the tenancy periods can be longer. However, mortgage borrowing costs also tend to be higher, and it is harder to get an interest-only deal, as opposed to a repayment mortgage.

Laura Suter, personal finance analyst, AJ Bell

How to track down lost pensions and should you consolidate them?

Read our checklist for the key issues to consider if you have multiple pensions held across different providers

The typical UK adult is now set to work for 11 different companies over the course of their career. The concept of a job for life is a rare one these days and, as a result, workers will tend to accumulate several smaller pension pots over their working life rather than just one. Keeping track of them can be tricky.

Auto-enrolment has got more people saving for retirement than ever before but many savers are not aware of which provider holds their pension, where it is invested or, crucially, how to track it down if they move job.

Research by adviser firm Tilney reveals that one in five UK adults has lost track of at least one pension pot. Losing paperwork, forgetting to notify the provider of a change of address or simply not taking an interest are all common reasons for losing sight of savings. And, worryingly, some 20% of people say they would have no idea how to find their pension if they did lose it.

Andy James, head of retirement planning at Tilney, says: 'Alongside property, pensions represent one of the largest forms of private wealth in the UK and, for most people, are going to be critical in funding their retirement lifestyle.

'Yet, despite this, many people are not sufficiently in control of these important financial assets, which are often scattered across multiple plans, forgotten about entirely or the paperwork has disappeared down the back of a sofa.'

PENSION TRANSFER CHECKLIST:

1. Check to see if older pensions have valuable benefits which could be lost if you move the money elsewhere
2. Check the exit fees
3. If you still want to move, check the investment range with the destination provider

HOW TO FIND A LOST PENSION

The first steps to finding a lost pension are digging out any old paperwork you might have or using the Government's Pension Tracing Service. This is a free online database of contact details for old and new pension schemes – all you need to know is the name of your former employer, pension scheme or provider.

Once you have contact details you can get in touch with old providers and ask for an up-to-date pension statement to determine how much you have saved and where it is invested.

You'll need to provide your name, address and national insurance number, as well as any previous addresses or names you have had.

KEEP SEPARATE OR CONSOLIDATE?

The next step is deciding what to do with the various pots. In some instances, transferring all of your pensions into the same pot is the best choice – it's far easier to just keep track of one account, often cheaper and your gains may compound more quickly.

But, for some people, this will be a mistake. Kate Smith, head of pensions at investment group Aegon, says: 'Pension consolidation won't be right for everyone – there are merits to not keeping all your eggs in one basket and some older-style pensions will have valuable benefits which may be lost on transfer.'

It is vital to check the small print before you transfer your savings. Older pensions in particular may have valuable benefits, which you would lose if you were to move the money elsewhere. Other savings vehicles may charge punitive fees if you transfer your cash elsewhere, which could offset the benefits of doing so.

But if an old pension has high charges and poorly performing investments, it may still be worth suffering an exit fee if you think switching to a low-cost account and greater range of funds will boost your pot over the long-term.

Justin Modray, director at Candid Financial Advice, adds: 'You'll need to do a careful comparison to determine whether transferring elsewhere is worthwhile – compare the costs and investment choices of the current pension to a low cost self-invested personal pension. Ideally you want a sensible balance between having access to a decent selection of investments and cost.'

ADDING UP THE VALUE OF YOUR PENSIONS

If you do decide to consolidate your savings then each of your existing pension providers should give you a transfer value, which is the amount you will have after fees and charges.

Each of your pots likely invests in different funds and assets with varying strategies – if you are opening a SIPP (self-invested personal pension) to manage your pension investments yourself, check whether it offers access to the funds, investment trusts and shares you want to hold.

You can sell all of the investments in your pension and transfer the money as cash into the new account before reinvesting it.

A benefit of doing this is that there are typically no charges for cash transfers. However, there are trading charges for buying and selling the investments and your money will be out of the market while it is transferred, which can often take several weeks.

IN-SPECIE TRANSFERS

Alternatively, you can transfer investments 'in-specie', meaning you remain invested while your holdings are moved from the old account to the new.

While this means you don't miss any time in the market, you won't be able to trade while your investments are being transferred and some providers will charge for each holding that is being moved, which can add up.

If your new provider doesn't have the fund you currently hold – it might be one that no longer exists – then it will have to be sold and the money transferred as cash.

Ms Smith adds: 'Nowadays the vast majority of jobs come with a pension and, as people frequently change jobs, it's all too easy to lose track of your pensions. But it's very hard to plan for retirement without a full view of your savings.' (HB)

Are you spending too little in retirement?

A new study looks at the financial habits of people in later life

How much of your pension pot should you spend in retirement? If you're intending to remain invested through drawdown in your later years, this question should be front-and-centre as you plan your retirement income strategy.

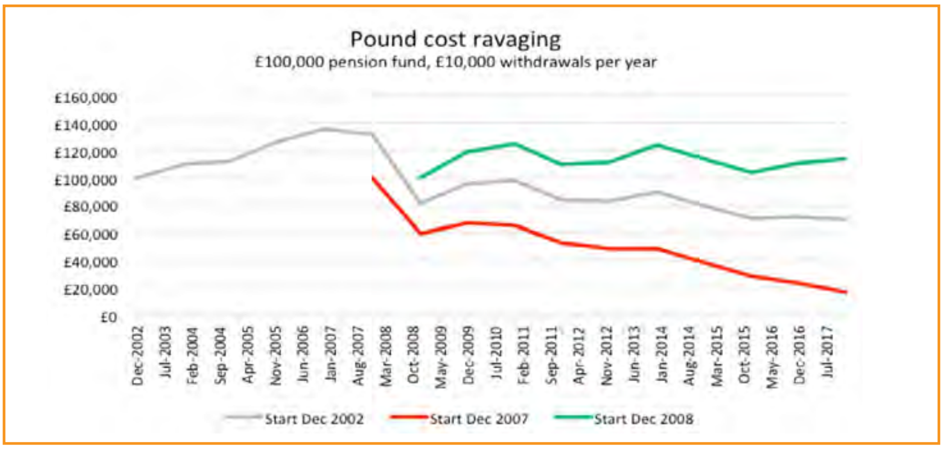
We've previously discussed the potentially deleterious impact a combination of large withdrawals and poor investment returns – so-called 'pound cost ravaging' – can have on your pension plans.

However, a paper published by think-tank the Institute for Fiscal Studies recently suggests underspending in retirement could be just as serious a problem.

According to the briefing note – which assessed how people spend non-pension wealth – most assets will be left untouched during retirement. The majority of this wealth is split between property (60%) and 'financial' (22%). Financial wealth includes things like money invested in ISAs, bank accounts and directly-held stocks and shares.

Real net financial wealth was, on average, drawn down by 17% between the ages of 70 and 80 and 31% between ages 70 and 90.

The study points out this is 'significantly slower than the decline in remaining life expectancy between these ages', meaning most people will not come close to spending all of their assets before they die.



Assumes fund is invested in FTSE All Share; total charges = 1%. Source: AJ Bell

SHOULD YOU BE SPENDING MORE IN RETIREMENT?

The findings could have implications for the pension freedoms and those using the reforms. They also mirror concerns raised in Australia, a country with a system offering similar levels of flexibility in retirement.

Down Under it was 'reckless conservatism' that was shown to be the biggest problem among retirees, with people taking an overly cautious approach to spending in later life and so potentially not making the most out of their savings.

How much you should spend in drawdown has been the subject of a significant amount of research, with most believing a healthy 65 year old can spend 3-4% of the initial value of their fund every year and be confident it won't be exhausted.

The extent to which this is true depends on the performance of your underlying funds, so it's vital you monitor your investments and withdrawal strategy and review regularly (at least once a year).

There are perfectly good reasons to not spend some of your assets. Drawdown pensions, for example, can be passed on to your loved ones tax-free if you die before age 75, or at your recipient's marginal rate of income tax if you die after age 75.

So if your priority is to leave something behind for others – perhaps in the knowledge you have enough secure income to fund your needs today – then leaving your retirement pot untouched can make perfect sense.

Tom Selby, senior analyst, AJ Bell

British American Tobacco shares struggle to fight back after 33% slump

Investors are increasingly worried about the risks facing the cigarette industry

Shares in **British American Tobacco (BATS)** have fallen by a third in value over the past 12 months as the market prices in the risks of tougher regulation, higher taxes and declining industry volumes.

British American Tobacco is now investing heavily in next generation products (NGPs) in the hope they will support future earnings and cash flow.

Investors will need to decide whether the shares fully discount all the bad news and are now oversold, or whether the risks are still too high to buy now.

Cigarette sales are in decline as people increasingly curb the deadly habit in favour of less harmful e-cigarettes and gadgets that heat tobacco without burning it.

Furthermore, British American Tobacco's £41.8bn takeover of Reynolds American last year increased its US exposure just as the US Food and Drug Administration announced plans to lower nicotine levels in cigarettes to non-addictive levels.

In its first half trading update (12 Jun), the £84.7bn cap highlighted strong revenue growth from its strategic brand portfolio, including *Dunhill*, Lucky Strike and *Pall Mall*.

However, it also cautioned that sales and profit growth would be skewed to the second half of the year – thus raising the risk of a profit warning if it doesn't achieve this second-half uplift.

British American Tobacco expects global industry volume to be down around 3.5% in 2018 as smoking rates fall, although it is confident in winning market share.

Less harmful cigarette alternatives are increasingly important to the big tobacco firms, facing competition from the likes of e-cigarettes play Juul Labs. The good news is the Reynolds American deal turned British American Tobacco into the world's leading vapour company.

And by the end of 2018, British American Tobacco plans to more than double NGP revenue to 'substantially more than £1bn' with a target to hit more than £5bn in 2022. Donald Trump's tax reform across the pond is freeing up cash to help fund a ramp up in NGP investment spend too.

In Japan, its tobacco heating product *glo* has a 4.3% national share and is in growth, despite the Tobacco Heating Products category slowing, while its *Vype ePen3* vapour offering launches in the UK in the third quarter.

As e-cigarettes' sophistication has increased, their popularity has surged and big tobacco players such as British American Tobacco are well placed to capitalise given their enormous research, development and marketing spending power.

Consensus estimates for 2018 point to earnings of 298.12p and a 203.01p dividend from British American Tobacco, puffing higher to 323.18p and 216.63p respectively in financial year 2019.

Based on the latter estimates, British American Tobacco swaps hands for 11.3 times forecast earnings and offers a 5.9% prospective dividend yield. (JC)

BROKER SAYS: 13 5 0

Air Partner has flown into more attractive valuation territory

The company has suffered a 24% drop in its shares since flagging an accounting error in April

We believe aviation services group **Air Partner (AIR)** is now more attractively valued after a share price de-rating in April caused by an accounting issue since resolved.

A strong set of results on 11 June gives us confidence in the business going forward, so buy the shares at 109p.

Air Partner says the aforementioned accounting error arose from certain financial journals being deliberately processed without effective review, resulting in an overstatement of £4m of net assets in the year to 31 January.

Following an in-depth review, the company concluded there was no clear motivation or evidence of personal gain and no customers, operators or suppliers were impacted.

According to Air Partner, it will book non-recurring costs of £1.3m following the review, which is expected to be expensed in 2018/2019.

Before the accounting issue was flagged and resolved, Air Partner was trading on a 15.5 times forecast earnings per share for the year to 31 January 2019.

Shares in the company have dived 24% since the accounting revelation and now trade on a more attractive price-to-earnings ratio of 11.8-times.

Air Partner charters aircraft to transport people or cargo and facilitates private jets. It also provides consulting and training services.

In the year to 31 January 2018, the company enjoyed robust trading in its charter division and continued progress in its consulting and training business, helping underlying pre-tax profit fly 23.7% higher to £5.8m. Market forecasts have pencilled in a pre-tax profit forecast of £7.3m in 2019.

The charter division delivered a 9.5% increase in underlying operating profit to £6.7m, which was driven by growth in commercial jets with higher demand emerging across territories from new and existing customers.

The ongoing FIFA World Cup in Russia is expected to further boost trading in the commercial jet broking business.

Earlier this year, Air Partner chief executive Mark Briffa revealed the company was already benefiting from higher demand ahead of the football tournament.

Air Partner's acquisition of turnkey air traffic control services provider SafeSkys has performed well. It was acquired in September 2017 in a bid to offer further safety and airport management support.

The company says it continues to assess organic investment opportunities and potential acquisitions under its growth strategy.

SHARES SAYS: ↗

Buy at 109p (LMJ)

BROKER SAYS: 2 0 0

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