

STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

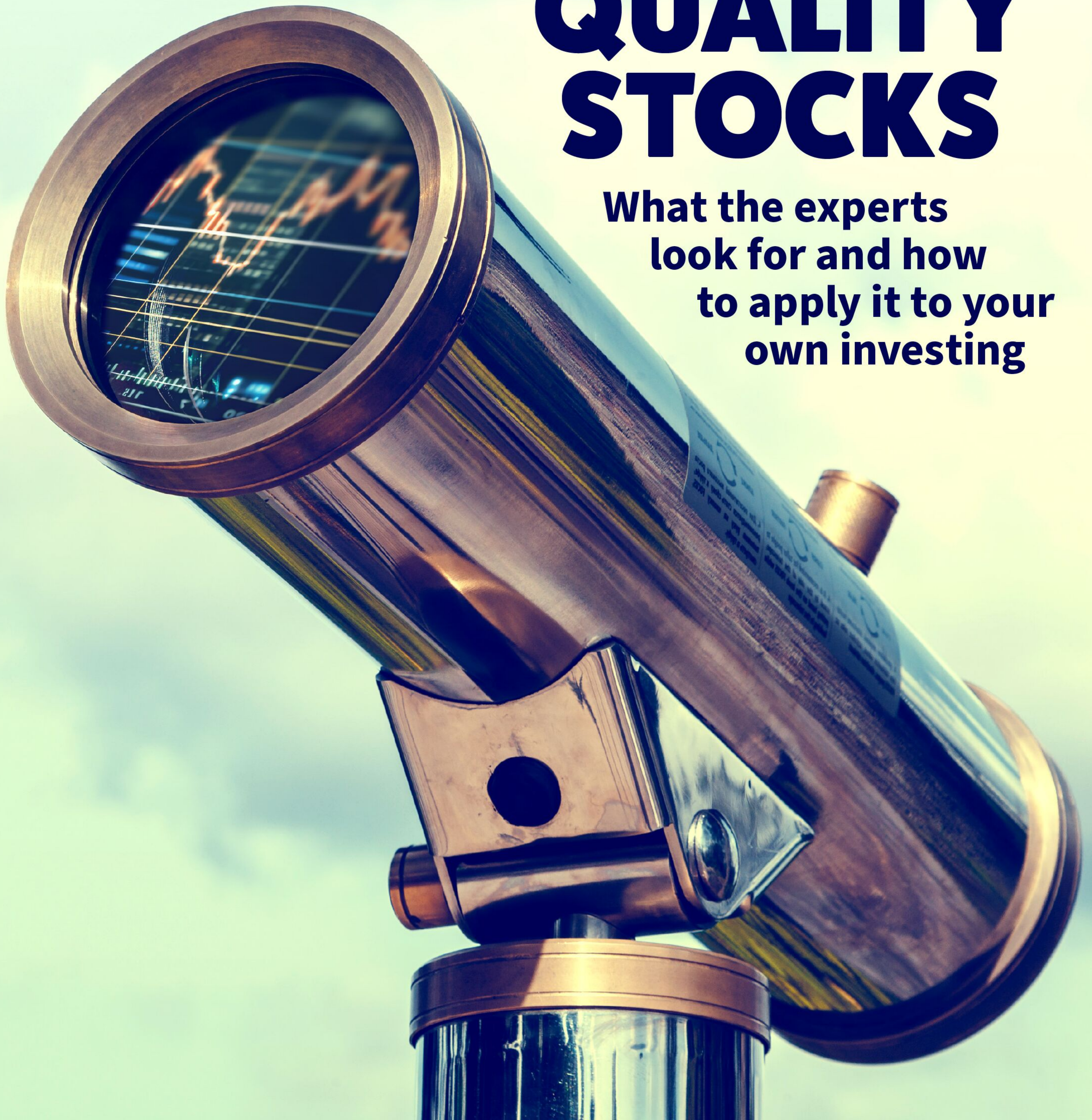
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SHARES

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HOW TO FIND QUALITY STOCKS

What the experts
look for and how
to apply it to your
own investing





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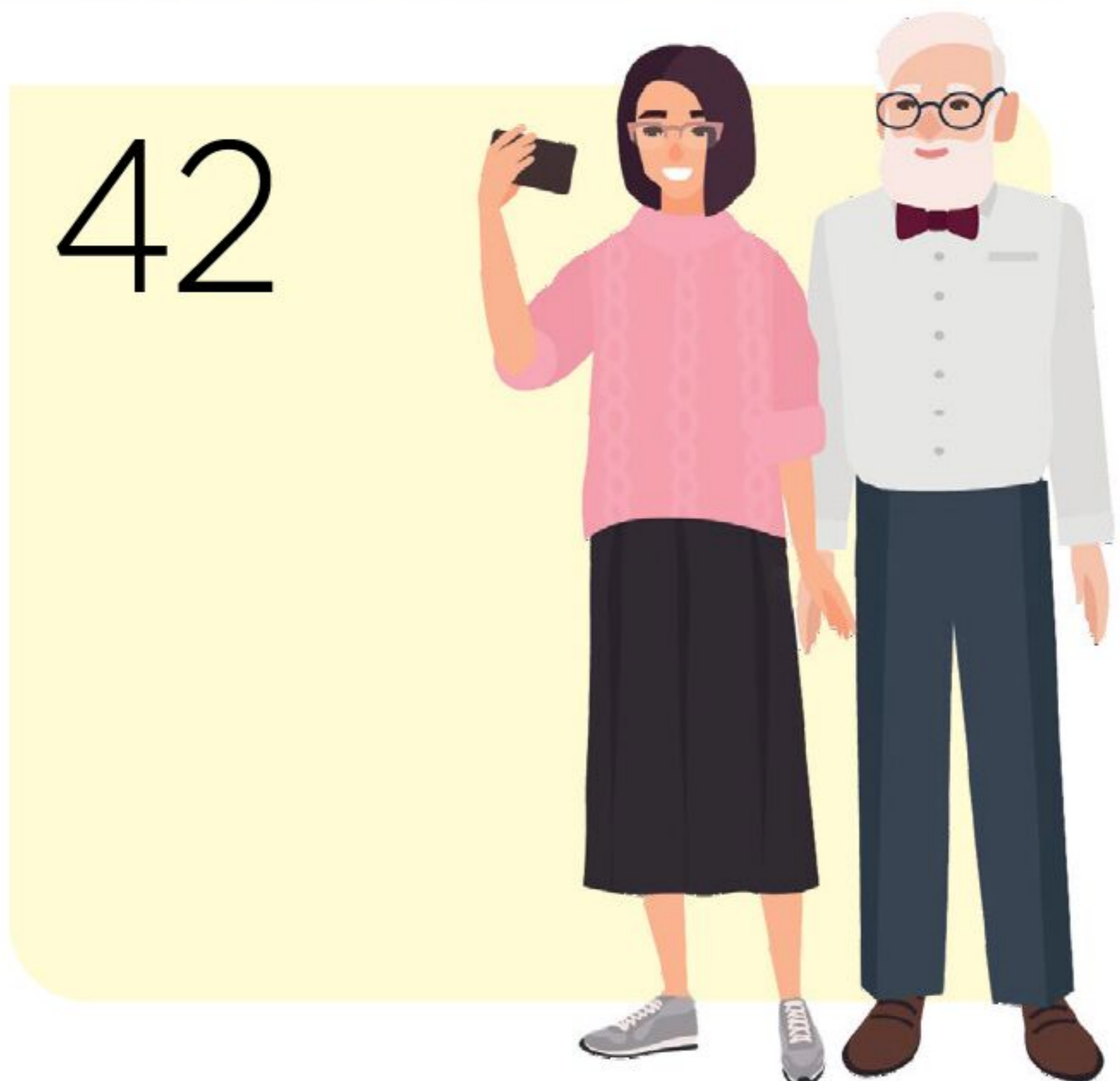
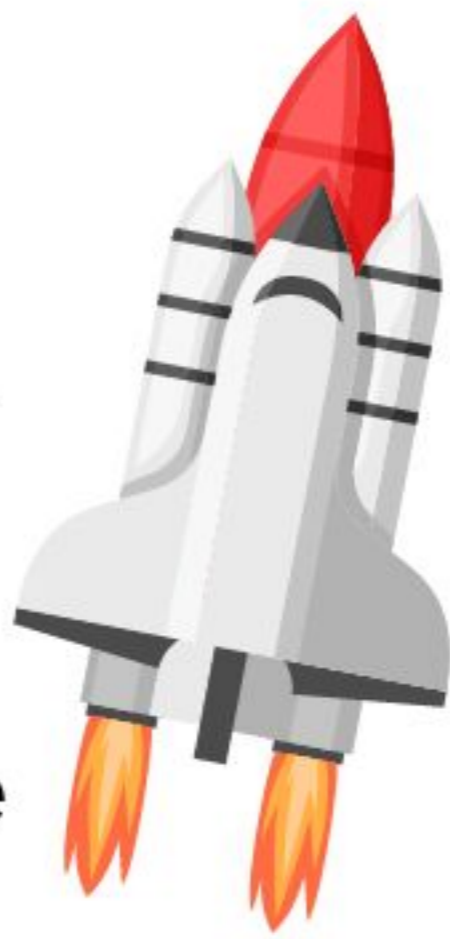
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Three important things in this week's magazine



1

How to find quality stocks

Canvassing the experts for how they define quality and looking for companies which fit the bill.



2

The ETFs which avoid Chinese exposure

China may be making a comeback in the short term but there are long-term reasons why this type of vehicle might appeal.



3

Three key things to look for in company results

This trio of steps will help you get to the nub of corporate earnings reports.

Visit our website for more articles

Did you know that we publish daily news stories on our website as bonus content? These articles do not appear in the magazine so make sure you keep abreast of market activities by visiting our website on a regular basis.

Over the past week we've written a variety of news stories online that do not appear in this magazine, including:



Oxford Instruments shares soar despite drop in earnings



CrowdStrike set for all-time high after bagging S&P 500 index spot



C&C shares slump 7.5% as CEO exits following accounting failures



Record breaking markets and \$3 trillion Nvidia | Wall Street Week



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European markets nervous as French president Emmanuel Macron calls snap election

Paris index falls over 2% to a three-month low and euro slides

European markets reacted badly to president Emmanuel Macron's call for a snap French election after far-right parties made major gains in the European elections held over the weekend.

Macron's decision on Sunday to suspend parliament and force an election next month was triggered by the far-right RN (Rassemblement National) securing 31.4% of the vote in the European parliament vote compared with 14.6% for the French president's centrist alliance party.

Stephane Sejourne, French foreign minister said: 'I think it's an election of clarification to lift the roadblocks.'

'Today the French electoral landscape shows 40% of those who voted chose a far-right list... yesterday's result is a lightning bolt in political life, we must take that into account.'

Far-right parties also made gains in Italy, Austria and Germany as 360 million voters went to the polls to chose 730 MEPs.

The French CAC 40 benchmark fell over 2% when markets opened on Monday while the euro fell 0.4% against the dollar and 0.3% against sterling as investors digested the news from Europe.

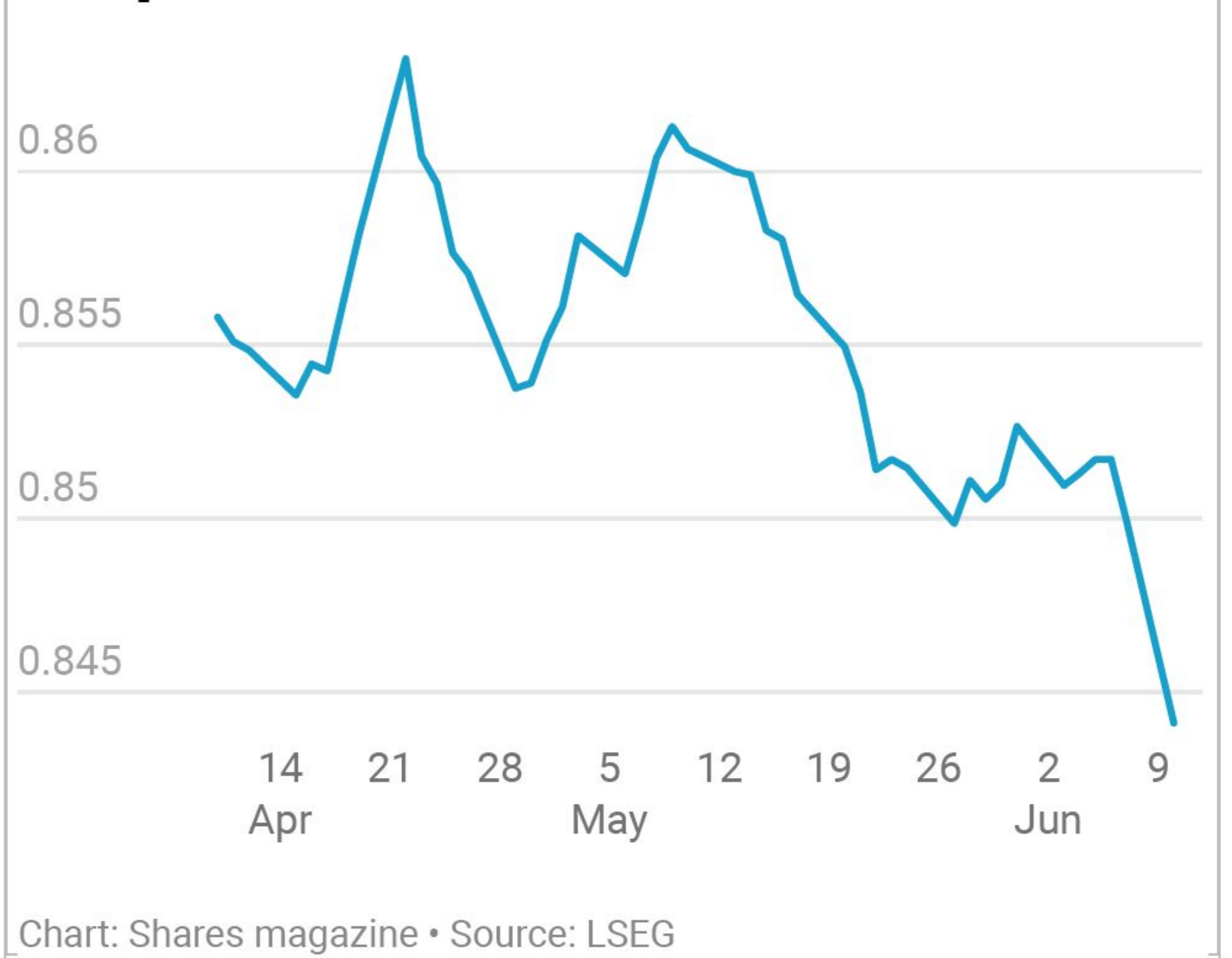
The FTSE 100 index and the German DAX index also declined, although the German chancellor was quick to say he would be not following in Macron's footsteps and calling a snap election.

The pan-European Stoxx 600 index was down 0.8% with banks, energy and motorway concession stocks leading the fallers.

Société Générale (GLE:EPA) fell over 7% to €24.10 and **BNP Paribas (BNP:EPA)** fell over 5% in morning trading.

Uncertainty over whether Macron will win the

UK pound to euro

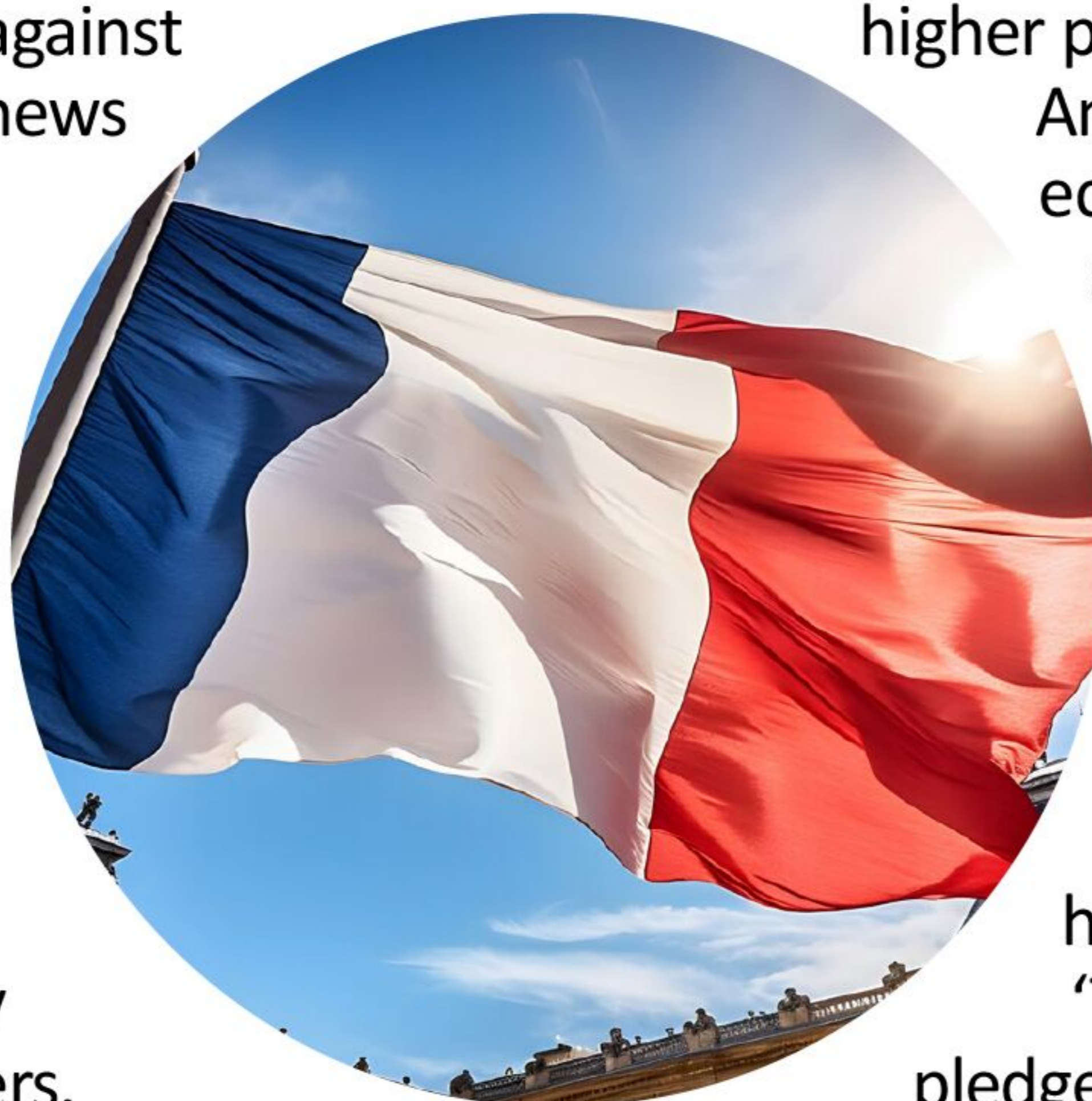


French election or hand victory to the right-wing RN party is likely to continue to weigh on French and European markets.

Investors sold off French government debt, with the yield on the benchmark 10-year OAT bond rising to 3.2%, on fears an RN victory would mean higher public spending.

Andrew Kenningham, chief Europe economist at Capital Economics, said: 'The immediate concern for the economy is this could make it even more difficult for the government to bring down the fiscal deficit, which was 5.5% of GDP last year, so it makes sense that the spread on French over German government bonds has widened.'

'The government has repeatedly pledged to bring the deficit below 3% of GDP by 2027 but has not spelt out how it will do so. While there is potentially a concern about spreads within the currency union as a whole, those risks currently seem low.' [SG]



Moderna in prime position to offer first combined flu/Covid shot

Analysts at Oppenheimer believe company's pipeline could yield five new drugs by 2026

Covid-19 stock market darling **Moderna (MRNA)** appears to be getting its mojo back with investors following a punishing 85% drop in the shares from their September 2021 highs.

Over the last six months Moderna's shares have more than doubled and despite the fall over the past couple of years, they remain one of the best performers in the benchmark S&P 500, notching up gains of 880% over the last five years.

The recovery is being driven by consistently good news emanating from the company's deep pipeline of new vaccines based on its mRNA technology which has the potential to revolutionise medicine.

Unlike traditional vaccines which are made from a neutered version of a virus and injected to teach the body's immune system how to identify the virus, mRNA uses the body's natural biological processors to treat disease and prevent infection.

Having developed the first effective mRNA-based Covid-19 vaccine, Moderna has come up trumps again after reporting (10 June) positive late-stage trial results from its combined flu and Covid-19 vaccine.

Chief executive Stephane Bancel believes a combined vaccine has the potential to reduce burdens on health systems and pharmacies, as well as offering more convenience that could improve compliance and provide stronger protection against seasonal diseases.

While the pandemic launched Moderna into the limelight and saw it generate peak revenue of over \$19 billion in 2022, the company's ambition reaches much further than a single product.

In total, Moderna has more than 45 products in development including a vaccine for the digestive system bug norovirus, as well as vaccines for AIDS

Moderna

(\$)



Chart: Shares magazine • Source: LSEG



and Zika virus.

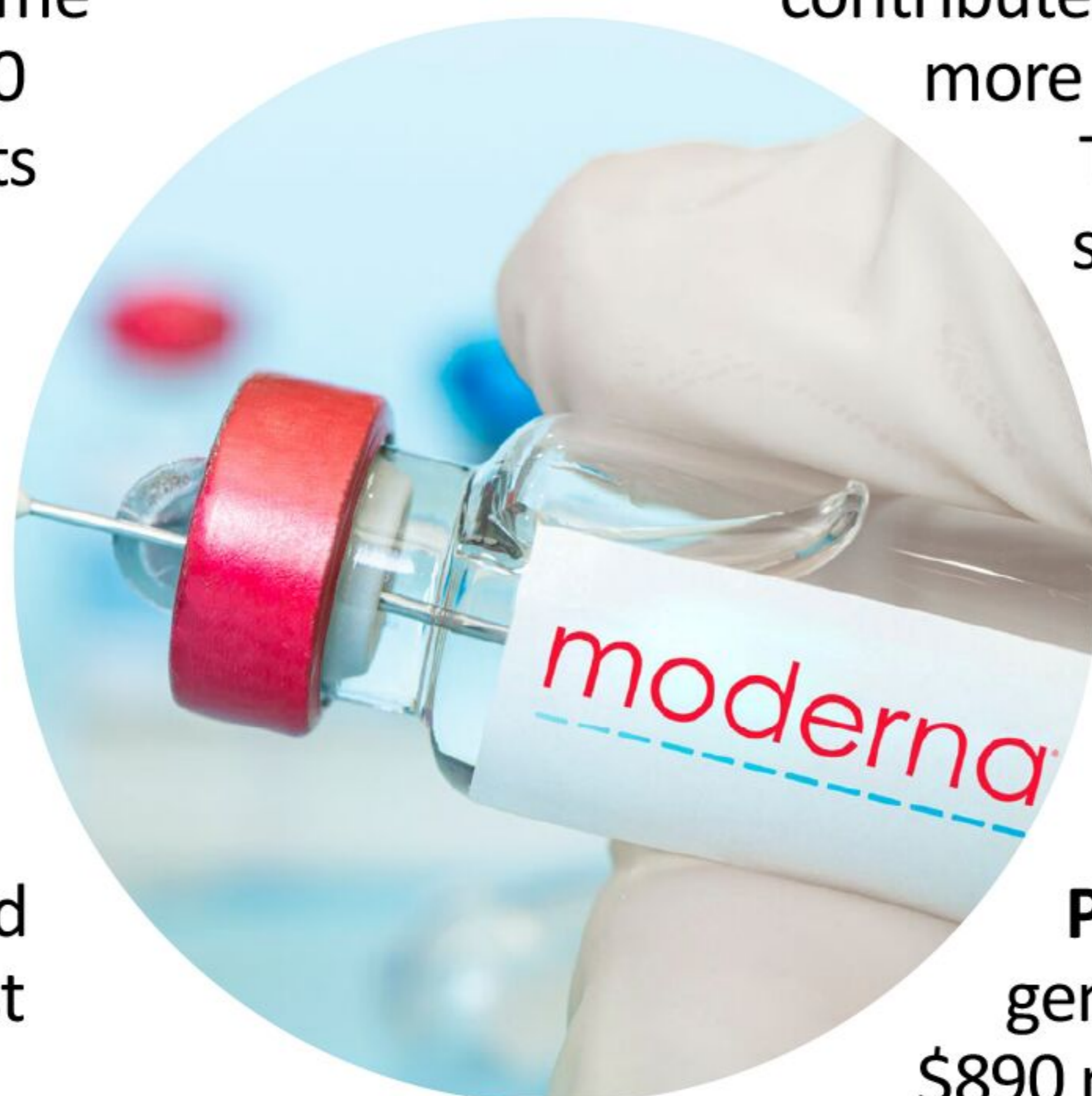
The long-term potential applications of Moderna's mRNA technology across several diseases is why the shares are a core holding for growth investor Ballie Gifford which manages the popular **Scottish Mortgage Trust (SMT)**.

Moderna received regulatory approval for its RSV (respiratory syncytial virus) vaccine in May which management believes, once launched, will contribute to total sales expected to top more than \$4 billion in 2024.

The virus causes cold-like symptoms and is a leading cause of pneumonia in babies and older adults, leading to 177,000 hospitalisations and 14,000 deaths in the US annually.

Moderna's treatment goes head-to-head with market leaders Arexvy, made by **GSK (GSK)** and **Pfizer's (PFE:NYSE)** Abrysvo which generated sales of \$1.2 billion and \$890 million respectively in 2023.

The biotech's drug pipeline includes a vaccine for melanoma, the deadliest skin cancer. In a prior study the vaccine, called mRNA-4157, when administered with **Merck's (MRK:NYSE)** Keytruda was found to help reduce the risk of recurrence or death by 49% in patients with melanoma. [MG]



Raspberry Pi float off to great start, can it reinvigorate UK-listed tech sector?

Low-cost computing play rises 30% on first day of trading

Affordable computer developer **Raspberry Pi (RPI)** made a stunning debut on the London Stock Exchange with its IPO (initial public offering) priced at 280p, the top end of the range, and the shares surging 30% higher to 360p in early dealings, valuing the company at nearly £700 million.

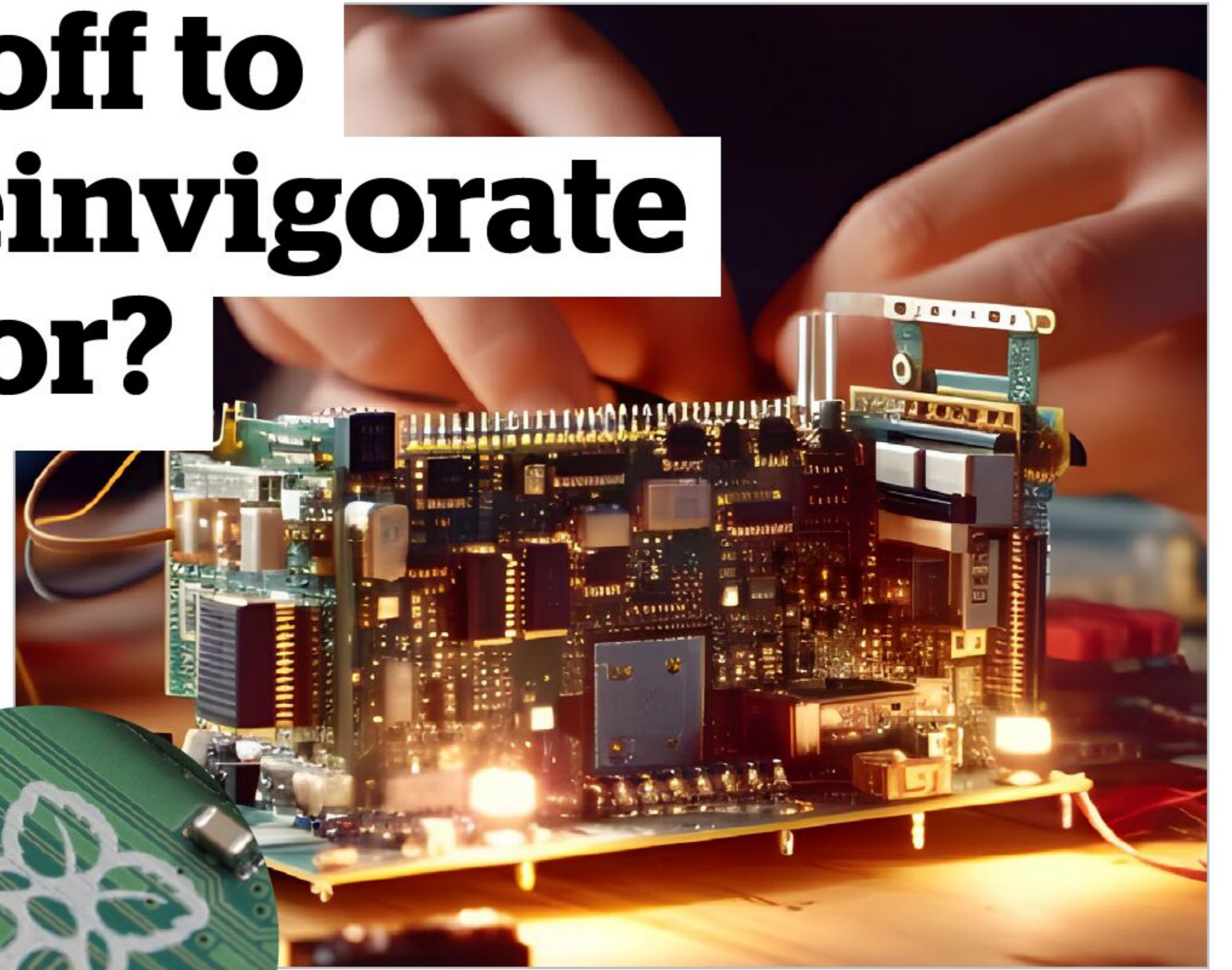
UK tech stories are few and far between in London, so investors will be hoping Raspberry Pi's success can attract more tech sector peers to the market.

Backed by strategic shareholders **Sony (6758:TYO)** and **Arm (ARM:NASDAQ)**, Raspberry Pi is already profitable and believes it can sustain its strong growth trajectory in a TAM (total addressable market) worth some \$21.2 billion (£16.7 billion).

Founded by chief executive Eben Upton in 2012 to make computing more accessible to young people, Raspberry Pi designs and develops low-cost SBCs (single board computers) and compute modules for industrial customers, enthusiasts and educators around the world.

The Cambridge-headquartered company also entered the semiconductor market in early 2021 with the launch of its first semiconductor product, the RP2040 microcontroller.

Raspberry Pi insists its computers are more efficient to manufacture and consume less energy



than legacy desktop and embedded PCs.

Since the company began trading in 2012, it has sold over 60 million SBCs and compute modules, 7.4 million of which were sold in the year to December 2023, when revenues ripened up 41% to \$265.8 million.

Pre-tax profit powered 90% higher to \$38.2 million last year. However, the company has flagged volatility in customer demand in 2024-to-date, which has led to 'higher than usual levels of inventory', although management expects this to normalise over the course of 2024 'resulting in stronger results in the second half of the year than in the first half'.

This creates some scope for disappointment if the second-half improvement isn't forthcoming.

AJ Bell investment analyst Dan Coatsworth says: 'Investors of all shapes and sizes have feasted on a slice of Raspberry Pi in what is the most significant IPO for the London market for a long time. It may only fall into smaller company territory, but this IPO is big from a strategic perspective.'

'It shows the UK is open for business to technology flotations and that investors are hungry for companies of any size if they tick the right boxes. There is a widely held view that tech companies only float in the US where they can potentially get a higher valuation. Raspberry Pi is proof that the UK can still compete against the likes of the Nasdaq and attract home-grown champions.' [JC]

Disclaimer: Financial services firm AJ Bell owns Shares Magazine. The author (James Crux) and editor (Tom Sieber) own shares in AJ Bell.

Raspberry Pi profit growth

	2021	2022	2023
Pre-tax profit	£18.5m	£20.1m	£38.2m

Table: Shares magazine • Source: Raspberry Pi offer circular

Character Group in the pink as it predicts full-year profit beat

Shares hit 12-month high on raised guidance after sparkling first half



Surrey-based maker of Peppa Pig, Teletubbies and Teenage Mutant Ninja Turtles toys, **Character Group (CCT:AIM)**, knocked earnings

forecasts into a cocked hat with its first-half results as pre-tax profit multiplied from £0.2 million to £2.2 million.

The firm said the jump in profitability in the six months to February was down to reduced selling and distribution costs and a £0.2 million positive 'mark-to-market' valuation of its financial hedges on the US dollar.

Cash from operations was £10.1 million, and with no long-term debt the firm is in a strong financial position.

'On the back of our first half-year's performance and the group's robust health, we anticipate profit before tax and highlighted items in respect

Character Group

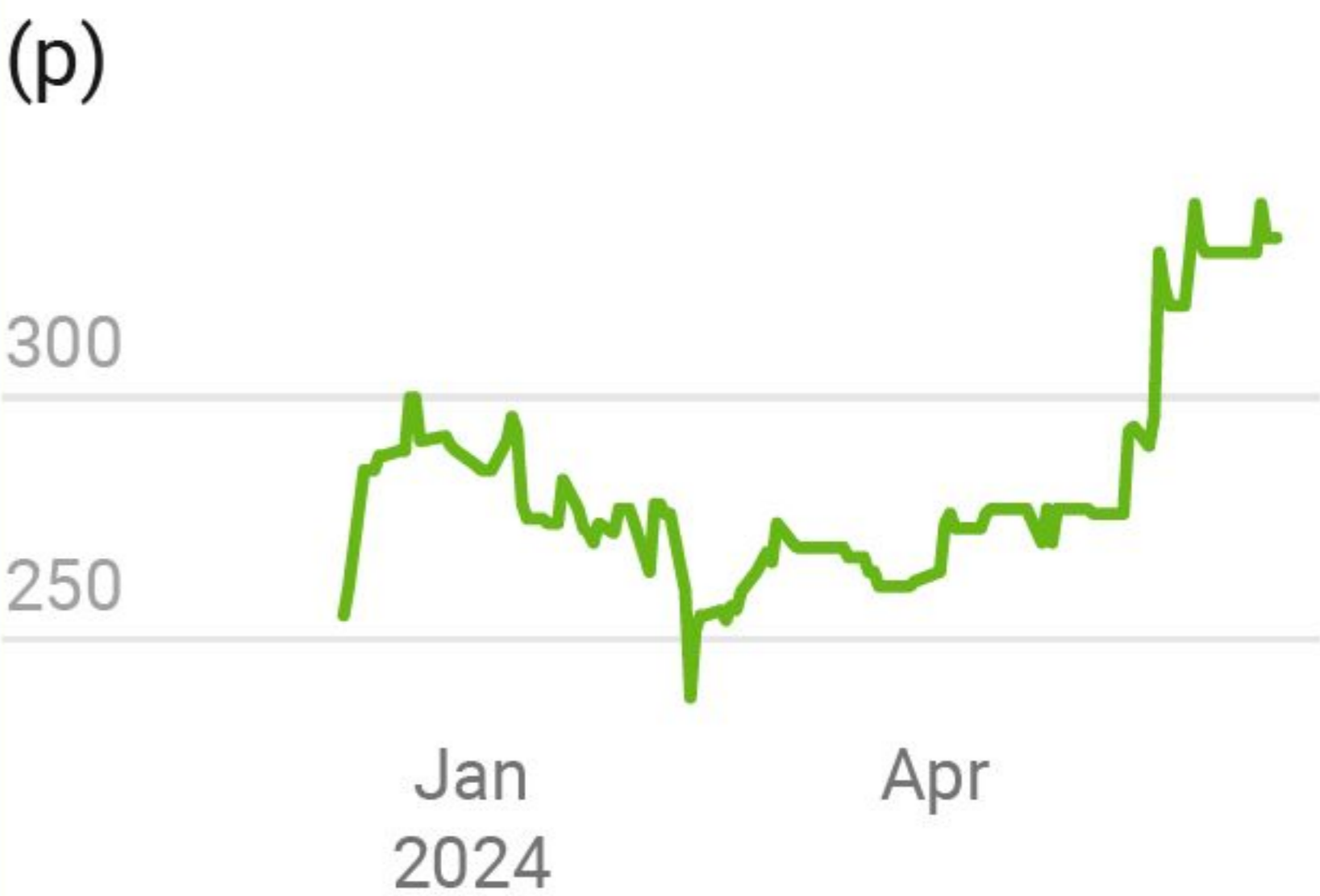


Chart: Shares magazine • Source: LSEG

of the full year to 31 August 2024 will exceed current market expectations,' said joint managing directors Jon Driver and Kiran Shah.

The duo also flagged the 'industry buzz' around some of the firm's new releases such as Heroes of Goo Jit Zu, which is already available on the Character Group website, and the Terror Fried range which it unveiled at the London Toy Fair. [IC]

Indivior shares give up gains ahead of move to the US

Analysts have revised up their earnings forecasts in 2024

Opioid-use disorder treatment specialist **Indivior (INDV)** shot out the blocks in the early part of 2024 driven by stronger than expected full-year profit, (22 February) a strong outlook and excitement over its proposed US Nasdaq listing.

Since then, the shares have lost nearly 30% of their value compared with a 6% gain in the mid-cap FTSE 250 index, making them one of the worst performers over that timeframe.



There does not appear to be any loss of momentum within the business which could have impacted investor sentiment. Management reiterated full year guidance at an analyst meeting as recently as 23 May in New York.

Revenue is anticipated to increase 18% at the midpoint of the guided range to \$1.28 billion while adjusted operating profit is expected to be in the range of \$330 million to \$380 million. The most likely explanation for the loss of share price momentum is the

Indivior



Chart: Shares magazine • Source: LSEG

move of Indivior's primary listing to the US. Passively managed funds tend to sell ahead of shares exiting certain indices they track.

Indivior first listed shares on Nasdaq in 2023 and the decision to move its primary listing across the pond is partially predicated on the shares achieving a high valuation. The company estimates around half of its shares are already owned by US investors. [MG]

UK UPDATES OVER THE NEXT 7 DAYS

FULL-YEAR RESULTS

17 June: Mind Gym

18 June: Tatton
Asset Management,
De La Rue, Telecom
Plus, Intercede,
Ashtead

19 June: Speedy Hire,
Severfield, Berkeley

20 June: CMC Markets,
Smith (DS)

FIRST-HALF RESULTS

18 June: Oxford
Biodynamics

TRADING UPDATES

18 June: SThree

US listing reports dominate agenda as Ashtead preps its full-year numbers

Equipment hire business does 90%
of its business across the pond

Equipment hire outfit **Ashtead (AHT)** is set to announce its results for the 12 months to 30 April 2024 amid swirling speculation it might consider shifting its primary listing to the US.

Around 90% of its business is done in the US so there is logic to the move but if its motivation is to attract a higher valuation – often the driver for a shift across the pond – it might ultimately prove to be disappointed. Its main US rival, **United Rentals (URI:NYSE)** grows faster but actually trades at a slight discount to Ashtead. Based on consensus forecasts, Ashtead is on a forward price to earnings ratio of 17.4 times compared with 14.6 times for United Rentals.

In terms of the upcoming numbers, investors might have been hoping for another record year after revenue and profit hit an all-time high in the year to April 2023, though this hope looks likely to be forlorn given a

What the market expects of Ashtead

	EPS	Revenue
2024	386p	£10.9bn
2025	407p	£11.5bn

Table: Shares magazine • Source: Stockopedia. Year end April

hit from the Hollywood writer's strike affecting activity in that industry and higher financing costs. Historically Ashtead has been an extremely consistent performer and a very reliable source of dividend growth.

The firm continues to invest in its own business and in M&A buying up small local competitors and integrating them and their customers into its network which adds to underlying growth.

The company has enjoyed decent momentum in recent years thanks to significant spending on construction and infrastructure in North America, some of which has been backed by the state. [TS]

Ashtead

(p)

6,000

5,000

Jul
2023

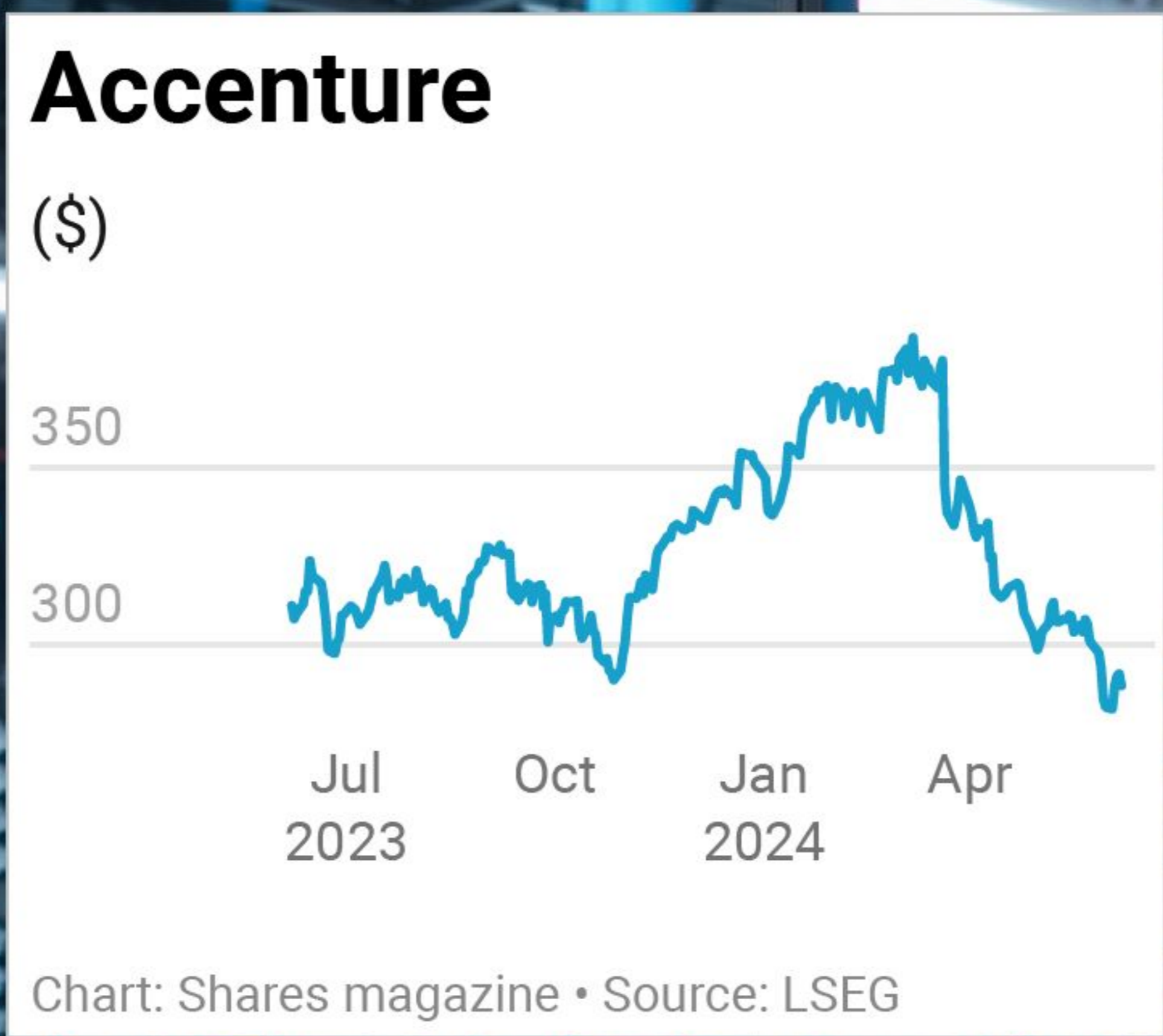
Oct

Jan
2024

Apr

Chart: Shares magazine • Source: LSEG





**US
UPDATES
OVER THE
NEXT 7
DAYS**



QUARTERLY RESULTS

18 June: Lennar
20 June: Accenture,
Carnival, Darden
Restaurants

Accenture needs to prove the doubters wrong with its next earnings update

The firm has already lowered guidance once, wiping billions off its market cap

Shares in IT services and consulting firm **Accenture (ACN:NYSE)** have been on the slide for the last three months, losing 26% of their value and cutting the market value of the company by almost \$70 billion.

In its second-quarter earnings report in March, the group disappointed analysts by posting flat revenue and a 2% decrease in bookings compared with a 14% increase in the first quarter.

Worse, the company lowered its full-year outlook for both revenue growth and earnings, with revenue now seen rising by 1% to 3% instead of 2% to 5%, while adjusted earnings per share are seen between \$11.97 and \$12.20 rather than \$11.97 and \$12.32 as the firm shaved

the top end of guidance. Investors are therefore on guard to see whether there is a further cut to the outlook when the firm reports third-quarter earnings on 20 June. Accenture has talked up its ‘early lead’ in generative AI, with over \$1 billion of bookings in the first half, and last week it deepened its collaboration with long-term software partner **SAP (SAP:ETR)**. The proof is in the pudding, however, and in the last three months analysts have trimmed their earnings expectations, but the question is, is it enough? [IC]

What the market expects of Accenture

	Year to Aug 2024	Year to Aug 2025
Revenue	\$65.3bn	\$69.6bn
Earnings per share	\$12.10	\$13.10

Table: Shares magazine • Source: Stockopedia. Data correct as of 7 June 2024

Strong payrolls stymie chances of a summer rate cut from the Fed

Markets are now forecasting a drop of less than 0.5% this year

As we cautioned last week, the release of the US non-farm payroll figures often has the ability to move markets and last Friday’s data did just that.

Rather than adding 175,000 jobs as the market expected, the US economy expanded fast enough in May to grow payrolls by 272,000, more than even the most bullish forecast, and average hourly earnings growth was also hotter than predicted.

Macro diary 13 June to 19 June 2024

Date	Economic Event	Previous
13-Jun	Eurozone April industrial production	-1.0%
	US May core producer prices	2.4%
14-Jun	UK June inflation expectations	3.0%
	US June inflation expectation	3.3%
	US June consumer sentiment	69.1%
17-Jun	China May retail sales	2.3%
	China May house prices	-3.1%
	UK June Rightmove house prices	0.6%
18-Jun	German June ZEW economic sentiment	47.1%
	Eurozone May core consumer prices	2.9%
	US May retail sales	3.0%
	US May industrial production	-0.4%
19-Jun	UK May core consumer prices	3.9%

Table: Shares magazine • Source: Morningstar, central bank



Once again, the increase was led by private health and education, leisure and hospitality and government roles, and while there may be questions over how the figure is calculated the market immediately marked Treasuries and stocks lower as expectations for US rate cuts were pushed out yet further.

Rather than three cuts this year and three next year, some economists are now betting on two or even just one cut this year with cumulative easing of 40 basis points or 0.4% by December.

All of which means the focus this week will be more on what the Federal Reserve says rather than what it does, in particular its commentary around core inflation, the labour market and consumer spending, which despite the signs of weakness in April remains the main engine of the US economy.

Like the ECB (European Central Bank), which last week cut interest rates claiming it had made ‘major progress’ in the fight against inflation, the Fed isn’t just trying to combat high prices but also the *expectation* high prices will become permanently embedded in the economy.

This will likely remain the theme for the remainder of this week and next week, with UK and US one-year inflation expectations published on Friday, UK and Chinese house prices released on Monday and UK and European core consumer prices due later in the week. [IC]

Next Central Bank Meetings & Current Interest Rates

Date	Event	Previous
20-Jun	UK Bank of England	5.25%
18-Jul	European Central Bank	3.75%
30-Jul	US Federal Reserve	5.5%

Table: Shares magazine • Source: Morningstar, central bank websites

Why Keurig Dr Pepper's shares are ready to pop



Market share gains, new management and a discount to Coca-Cola and PepsiCo are reasons to consider this North American beverages play

Keurig Dr Pepper
(KDP:NASDAQ) \$34.60

Market cap: \$46.9 billion



Investors seeking to pep up portfolios with a quality consumer staple selling at a discount to peers should consider **Keurig Dr Pepper (KDP:NASDAQ)**, the North American beverages pure-play whose attractions include a diverse brand portfolio, pricing power and the cash generation to support progressive dividends and share buybacks.

Shares believes this is a tasty time to buy the shares, since Dr Pepper recently crept past Pepsi as America's number two soda brand in the culmination of years of steady market share gains.

This demonstrates the peppery soda's growing appeal and we are excited about Keurig Dr Pepper's future under new chief executive Tim Cofer, a seasoned consumer packaged goods executive with 25 years of experience at **Mondelez (MDLZ:NASDAQ)** and a formidable track record of driving growth, leading transformations and creating shareholder value.

While **Coca-Cola (KO:NYSE)** and **PepsiCo (PEP:NASDAQ)** capture most of the attention in the soft drinks industry, Keurig Dr Pepper offers similar attractions but at an appealing discount with scope to narrow in the years ahead as the group takes market share and delivers earnings upgrades.

According to Stockopedia, Keurig Dr Pepper's shares sell for 18 times prospective 2024 earnings with a dividend yield of 2.5% while Coca-Cola trades on 22.6 times forward earnings and PepsiCo 20.9 times, premiums which reflect the perceived higher quality of two big competitors which have greater scale and entrenched global market positions.

Keurig Dr Pepper



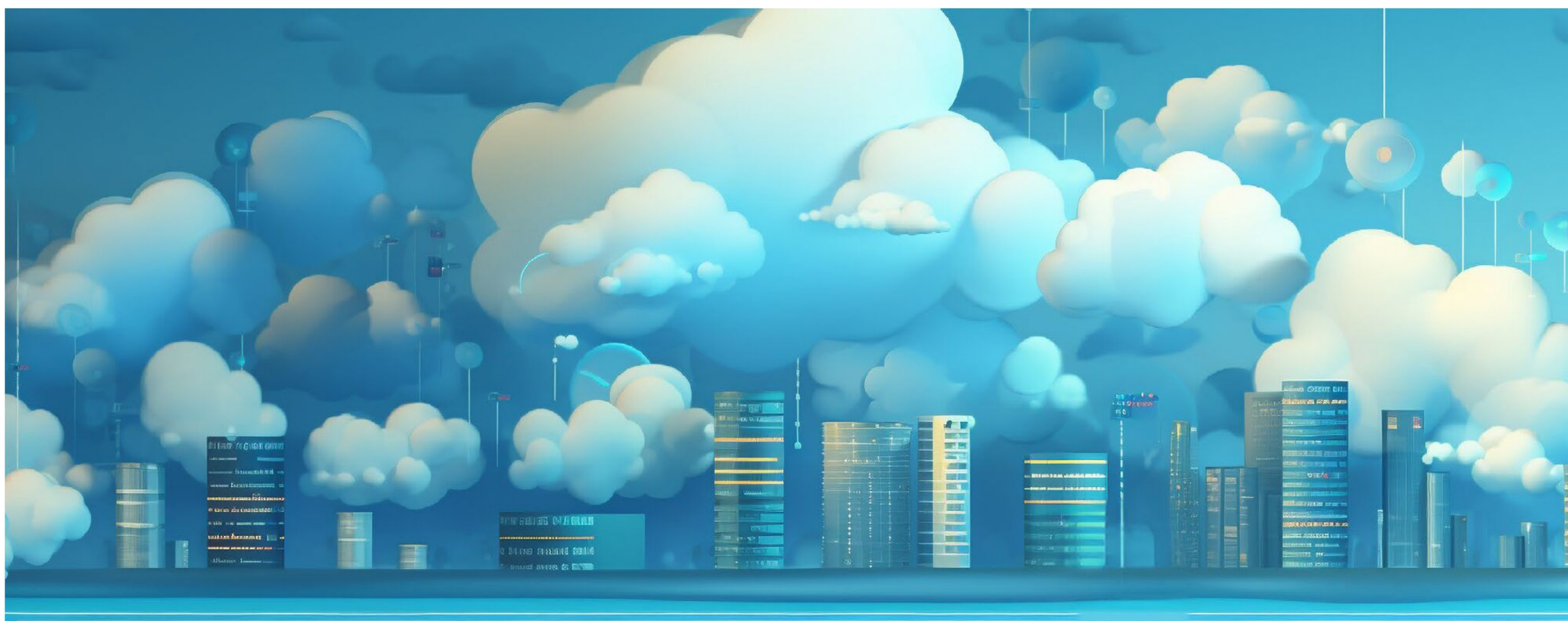
Chart: Shares magazine • Source: LSEG

However, Keurig Dr Pepper has a palate-pleasing growth story all of its own thanks to a portfolio diversified across more than 125 owned, licensed and partner brands.

Besides producing the iconic, purplish-red canned Dr Pepper tipple and drinks brands ranging from Snapple to Canada Dry, the company also distributes coffee brewers and single-serve coffee pods under the Keurig and Green Mountain brands and continues to diversify its portfolio into faster-growing beverage categories.

In 2023, Dr Pepper edged ahead of Pepsi as the US's number two soda brand according to data from trade publication *Beverage Digest*. Unsurprisingly, Coke remained the leader by some margin with 19.2% of the US soda market by volume, while Dr Pepper and Pepsi both had 8.3% with Dr Pepper a smidge ahead which feels significant in terms of momentum.

As Dr Pepper has been gaining, Pepsi has been declining as management has focused on the group's enormous global snacks business. That leaves Keurig Dr Pepper well-placed for growth from a lower base as a pure-play beverages firm with Cofer leading its next phase of growth. [JC]



Cerillion is a built-in-Britain quality tech growth stock that you should own

Billing and customer management platform ticks so many investor boxes

Cerillion

(CER:AIM) £15.78

Market cap: £565 million

BUY

Not every investor will back young (ish) technology-led growth companies because it often means being willing to steal yourself through years of painful losses at the start of the journey. It's why so many feel the need to look overseas for sustainable tech growth, with real profits and cash flows.

But while built-in-Britain opportunities in the space may be rare, they do exist, and *Shares* believes that **Cerillion (CER:AIM)** is one of them. If you've not come across the company before, in short, it scores very highly on core quality growth metric like returns on capital, equity and operating margins, throws off oodles of cash and appears to have years of growth runway before it.

Data suggests a global opportunity in this space worth \$70 billion by 2027, so while it doesn't operate across that entire scope (it doesn't work in China, for example) it's still an enormous opportunity, with potential to scale out vertically into other utility industries, like water, and electricity, for example.

Cerillion

(p)



Chart: Shares magazine • Source: LSEG

WHAT THE BACKGROUND?

It floated in 2016 on the junior AIM market, which may be one reason why you might have missed its progress, but has been around for nearly three decades, having been spun-out via a management buyout from Logica in 1999, and it is still led by Louis Hall, chief executive, and the main driver of that spin-out.

Cerillion built its reputation on an integrated enterprise billings and customer relationship

Cerillion's free cash flow

£ (million)

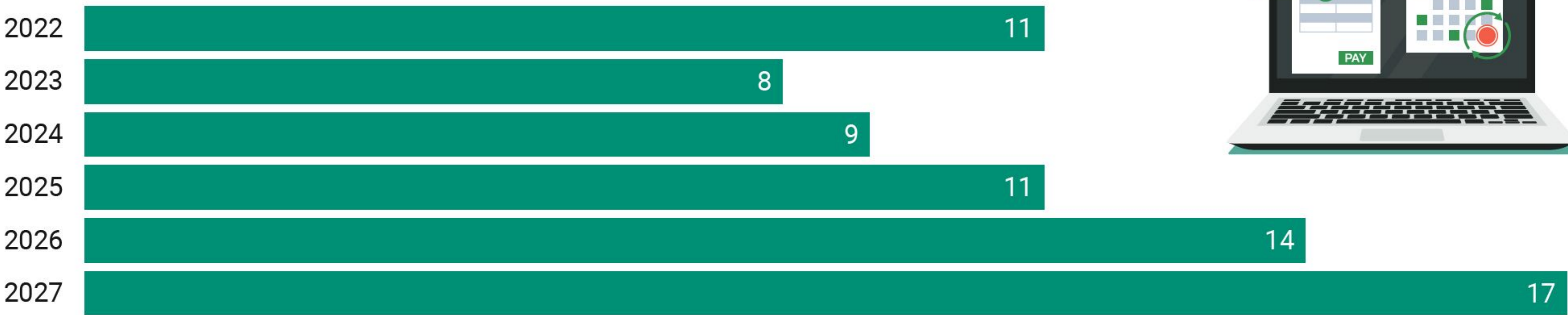
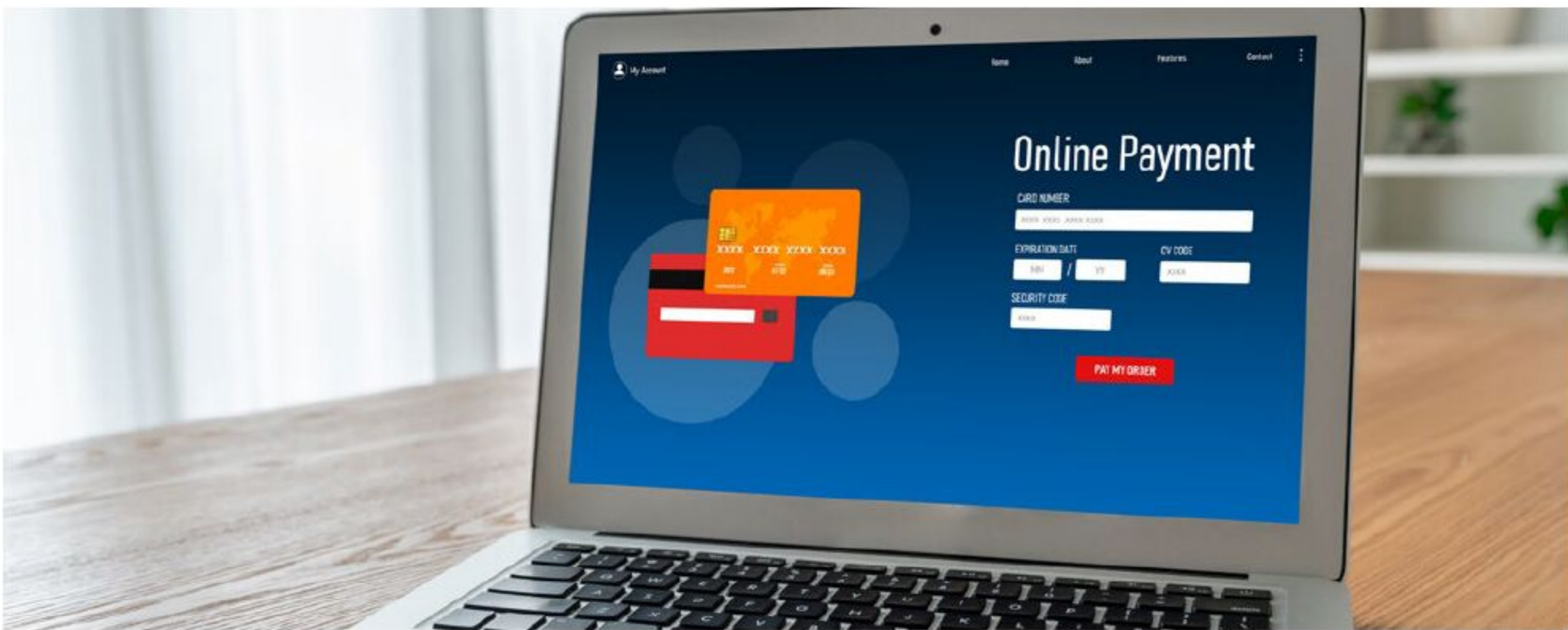


Chart: Shares magazine • Source: Berenberg, Liberum forecasts



management software platform sold to telecoms companies, particularly tier two and three operators. But it has expanded the suite over the years to cover charging, interconnect, mediation, and provisioning solutions.

The company names clients including **KDDI (9433:TYO)**, listed in Japan, India's Airtel, and Manx Telecom, the Isle of Man operator that used to be listed on the London market until its 2019 private equity buyout. More familiar names like Three, Virgin Media and Cable & Wireless are also on the list.

ATTRACTIVE OFF-THE-SHELF SOLUTIONS

Crucially, Cerillion's suite offers the industry the kind of flexible, off-the-shelf solutions needed to monetise vast capital investment in new 5G mobile (6G is coming) and fibre networks in a savagely competitive market environment.

Increasingly selling five-year software-as-a-service contracts, Cerillion's investment in its IT suite and headcount (US in particular) means it has more tools in its stack to sell to clients, so average contract sizes have been rising. This is evidenced by November 2023's first tier one client, an unnamed European telco, worth €12.4 million over the full term of the contract, and an \$11.1 million deal with a South African operator, announced in May 2024.

This helps explain a consistently growing new sales pipeline that hit a record £254 million in the first half

of fiscal 2024 (to end of September). Annual recurring revenues account for about two-thirds of the firm's £22.5 million sales, particularly sticky given the value proposition, switching difficulty and costs.

IMPROVING QUALITY

Operating margins continue to expand to 43.4% in the first half, showing that Cerillion is keeping a firm grip on running costs. It threw off £4.7 million of free cash leaving the company debt free with £26.6 million net cash on the books.

It pays modest dividends, the full year yield is about 0.8%, but investors would be buying for growth, not income. And overall, shareholder returns have shone. In three years returns on capital and equity have grown from 29.7% to 37.3% and 35.5% to 40.7% on equity.

In five years, the stock has soared 928%, and 2,005% since IPO, and now trades on rolling 12-months PE (price to earnings) multiple of about 30, according to Stockopedia data. But we believe long-run growth stories like Cerillion need to be judged over several years, not just the next year.

Using forecasts out to full year 2026 supplied by Berenberg and Liberum implies an average PE of near 25 over that period. And both brokers suggest upside risk to their estimates. One final point, Cerillion could be targeted by private equity firms. Hall owns just over 30% of the shares, so any offer would have to be compelling and at a sharp premium to current valuations.

But as we have seen in recent years, private equity buyers have cash to splash and are keen over UK quality assets possibly trading at discounts to overseas peers. So, no takeover slam dunk, but it's another factor to build into your investment decision. [SF]

ME Group remains attractively valued

A seasonally strong second half and improving sales mix is expected

ME Group (MEGP) 162.6p

Gain to date: 1.8%

In February 2024 we highlighted the underappreciated competitive strengths of instant-service equipment designer, maker and operator **ME Group (MEGP)**.

The company, formerly known as Photo-Me International, has built a dominant market share in its chosen segments giving it unrivaled geographical diversification which provides growth opportunities not reflected in the rating of the shares.

The firm’s unique business model and inherent strengths allow it to generate high returns on the capital it deploys and consistent cash flow.

WHAT HAS HAPPENED SINCE WE SAID TO BUY?

Results for the half year to the end of April showed continued business momentum with revenue up 8.6% on a constant currency basis and pre-tax profit climbing 13.6%.

The Wash.Me laundry machine business was once again the fastest-growing area with underlying



revenue up 19.6% (17.4% on a currency-adjusted basis) as the number of Revolution machines in operation grew 18% on the previous year.

The group continues to roll out its machines in high-footfall locations such as supermarkets and petrol forecourts, and its pipeline suggests it will deploy a record number of machines this financial year.

Despite underlying strength in the business which Berenberg believes puts the company on track to beat full year profit estimates, investors took a less rosy view with the shares dropping 5% on the day of the results.

Foreign currency headwinds were the culprit, cutting reported group revenue growth almost in half to 4.6% with the brunt of the impact felt in the photobooth business which saw growth slip to 2.3% from 7.4% excluding foreign exchange movements.

During the first half the Japanese yen fell 15% against sterling and the euro slipped around 2%.

The board gave a positive outlook saying it expected the business to deliver another record year of profit, in line with market expectations.

WHAT SHOULD INVESTORS DO NOW?

The long-term investment case remains intact, while the business looks in good shape to deliver another record year of profitability in 2024 which implies a pre-tax profit of £73.6 million based on consensus forecasts.

With a dividend yield close to 5% and high single-digit profit growth, the shares remain attractively valued relative to the growth potential and quality of the business. [MG]



Gateway to Vietnam

Vietnam Enterprise Investments Limited
(VEIL) is hosting the Gateway to Vietnam
Forum on 25th June 2024 in London

The VEIL AGM will be held as part of the Forum. Existing shareholders and those interested in finding out more about VEIL are very welcome to register for the event in London. Remote access is available upon request.



To register, please scan the QR Code and complete
your details by Thursday 20th June 2024.



VEIL

HOW TO FIND QUALITY STOCKS

**What the experts look
for and how to apply it
to your own investing**



By James Crux
Funds and Investment Trusts Editor

‘Quality investing’ is the style pursued by the world’s most famous investor Warren Buffett and Terry Smith, arguably the best-known British fund manager who runs the five-star Morningstar-rated **Fundsmith Equity (B41YBW7)** and consistently favours quality firms. Quality investing has generated strong long-run returns for its practitioners, including Buffett, but how do the leading fund managers offering private investors exposure to the style actually define quality?

QUALITY INVESTING DEMYSTIFIED

Put simply, quality investors focus on profitability, financial strength and stability when assessing companies. Quality investing entails putting money to work with best-in-class businesses that have the ability to generate consistent returns over the long term and can protect and grow their value across market cycles. Investors should expect to pay more for a quality business, since shares in these durable firms are highly prized and rarely, if ever, cheap. But as the classic Buffett quote goes: ‘It’s far better to buy a wonderful company at a fair price, than a fair company at a wonderful price.’

HUNTING FOR HIGH RETURNS

Terry Smith seeks out companies with sustainably high returns on capital and crucially, a source of growth to invest those good returns back into. The no-nonsense East End native favours businesses with a degree of predictability – Smith is a fan of companies that make money from a large number of everyday, predictable transactions – and also looks for a degree of management skill in terms of capital allocation.

Names passing muster with Smith range from **Microsoft (MSFT:NASDAQ)** and **Novo Nordisk (NOVO-B:CPH)** to **Visa (V:NYSE)** and **LVMH (MC:EPA)**.

Sanford DeLand manages the **CFP SDL UK Buffettology (BFOLDZ3)** and **CFP SDL Free Spirit (BYYQC27)** funds according to the philosophy of ‘Business Perspective Investing’, the successful strategy associated with Buffett and other Ben Graham disciples.

‘Quality is right at the top of what we do,’ says Eric Burns, Sanford DeLand’s chief analyst and manager of running *Shares* Great Ideas pick CFP SDL Free Spirit. ‘We are primarily business analysts looking for quality businesses and there

are two aspects to it, the qualitative side and the quantitative side, and the two go hand in hand.’

On the qualitative side Burns and Buffettology manager Keith Ashworth-Lord place great store in ‘Porter’s Five Forces’, a framework for understanding the competitive forces at work in an industry – the five forces include competitive rivalry, supplier power, buyer power, threat of substitution and threat of new entry – in order to gauge where a company sits in the competitive environment. ‘Is it going to be around in 10 years’ time, get eroded away by competition, or it beholden to suppliers?’, are the questions Burns needs to answer.

‘High returns on capital and high return on equity are the marks of a quality business,’ he informs *Shares*. ‘Because if a company can earn a return over and above its cost of capital it is creating value for the shareholder. Ultimately that is what’s going to generate your long-term return. A business that is not generating an adequate return is going to destroy value over time.’

Burns and Ashworth-Lord focus on ROE (return on equity) as the main metric rather than ROCE (return on capital employed). ‘It is all very well generating a return on your capital, but for us it has got to be a cash return. We are only interested in businesses that have a high cash conversion rate, anything over 80% as a starting point,’ stresses Burns, who also looks for robust balance sheets (most of the companies in Free Spirit have net cash).

‘On the quantitative side, the business ought to be growing,’ says Burns, who highlights Buffettology holding **Rightmove (RMV)** as a business ‘growing the top line at a decent rate. We also look at sales and profit per employee, which tells you if management is expanding the business in a sensible way. I would struggle to think of a higher quality business on the UK market than Rightmove. Over five years, Rightmove’s return on average capital employed is 297%, if only they could all be that good. Cash conversion is exemplary and since Rightmove doesn’t have a cost of goods sold, its 100% margin at the gross level.’

RESILIENCE IN TOUGH TIMES

Tomasz Boniek, who supports James Harries in managing the **STS Global Income & Growth Trust (STS)**, says a quality company must have three



JOE BAUERNFREUND, CEO & CIO - ASSET VALUE INVESTORS

‘Many so-called value investors are drawn to companies that are priced cheaply by the market. Often, these companies trade cheaply for a reason,’ says Joe Bauernfreund, CEO & CIO of investment manager Asset Value Investors.

‘A classic example is a conglomerate owning one good business and one poor quality business. The conglomerate as a whole trades at a discount to its theoretical sum of the parts value, but in many respects, this is an example of the market being efficient. The conglomerate trades at a discount because the poor-quality business is likely to continue to depreciate in value, and it becomes a race against time for that business to



be monetised before it declines further in value, dragging down the sum of the parts value.

‘At AVI we aim to avoid these kinds of situations. The discounted valuations we exploit will typically be in companies where we believe that the sum of the parts value is likely to increase over time, and this leads us to invest in good quality/growing businesses, but at discounted valuations. “Good quality” therefore reflects our belief that a particular business will continue to grow its profits and hence see its value appreciate. Businesses with market-leading positions; high margins and a track record of consistent growth would meet our criteria.’

attributes: strong financial productivity, a well-defined and sustainable growth opportunity and a good management team. ‘When we think about financial productivity, we look at metrics like gross margin, operating margin, return on invested capital (ROIC) and free cash flow conversion. Companies that are financially strong also tend to require little debt to finance their operations, which leads to resiliency in tough economic conditions, a key attribute of all Troy Funds.’

Boniek also firmly believes that extensive qualitative analysis is required to understand why a company is financially productive. ‘Specifically, we like to see companies that have a strong competitive position, either because of demand-side advantages (brand, product quality, consumer lock-in) or supply-side advantages (low-cost provider, unique operating model). Finally, quality companies generate significant amounts of excess cash. How a management team distributes this cash matters greatly for investment returns. We dislike strategic acquisitions, and we favour companies that reward shareholders via dividends without compromising the company’s ability to reinvest back in the business.’

DON'T DISMISS VALUATION

‘We look for sustainable high growth, including margins, returns on investment and cash flows,’



says Gerrit Smit, portfolio manager of the **Stonehage Fleming Global Best Ideas Equity Fund (BCLYMF3)**, which also homes in on qualitative measures like company culture and management expertise when building the fund’s portfolio.

‘Valuation remains critical for us,’ Smit adds, but rather than focus purely on the next 12 to 18 months, the Stonehage Fleming manager believes three-year PEG ratios (price to earnings growth) give a better measure of a stock’s compounding growth potential. But being such a stickler for value can mean missing out on some very good opportunities, Smit admits. ‘We missed good returns on **Apple (AAPL:NASDAQ)** because we didn’t have the conviction on organic growth and valuation,’ he says. Industrial cleaning company **Cintas (CTAS:NASDAQ)** is another stock that missed the cut. ‘At 35-times PE, we underestimated the growth potential,’ he says. ‘Now it trades on a PE of 40.’

NICHE MARKET LEADERS

Ed Wielechowski, who manages **Odyssean Investment Trust (OIT)** alongside Stuart Widdowson, tells *Shares*. ‘We think about business “quality” across three different areas, i) financial characteristics; ii) market and value chain position; and iii) management team - looking for a range of quantitative and qualitative factors across these areas. Financial metrics we look for, include high and consistent cash return on capital employed and

QUALITY FACTOR ETFS

Low-cost exposure to quality stocks is possible through exchange-traded funds (ETFs for short). There are several vehicles which apply quality factors to different countries and regions and some which have a sustainability or income skew too. A product like **iShares Edge MSCI World Quality Factor (IWFQ)** gives you global exposure and is a good example to compare with an ETF which simply tracks the broad MSCI World index like **iShares Core MSCI World (SWDA)**.

The quality-focused ETF has delivered modest but still material outperformance versus the broader-based alternative on a five-year view, 13% versus 12.4% on an annualised basis, though this does come at a higher ongoing charge of 0.3% versus 0.2% for its more vanilla counterpart.

Rough calculations suggest even with the disparity in charges you would still have generated a better return with the quality factor instrument.

The underlying MSCI World Quality Factor

index is built to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity, stable year-over-year earnings growth and low levels of borrowing. It covers around 20% of the overall MSCI World index and the subset of stocks is unsurprisingly more expensive than the broad index.

As the rest of this article explores, there's more to identifying quality stocks than just crunching numbers and some global, actively managed funds and investment trusts with a focus on quality have delivered a better return than the iShares Edge MSCI World Quality Factor.

For example, popular quality play **JPMorgan Global Growth & Income (JGGI)** has served up an annualised return of 15.5% (albeit at a significantly higher ongoing charge of 0.63%).

Many active quality funds though will have fallen short even of the straight MSCI World given the exceptional performance of the big tech names which have dominated this index in recent times. [TS]

Average price to earnings ratio of iShares Core MSCI World constituents: 21.7 times

Average price to earnings ratio of iShares Edge MSCI World Quality Factor constituents: 25.2 times

How quality factor ETF compares

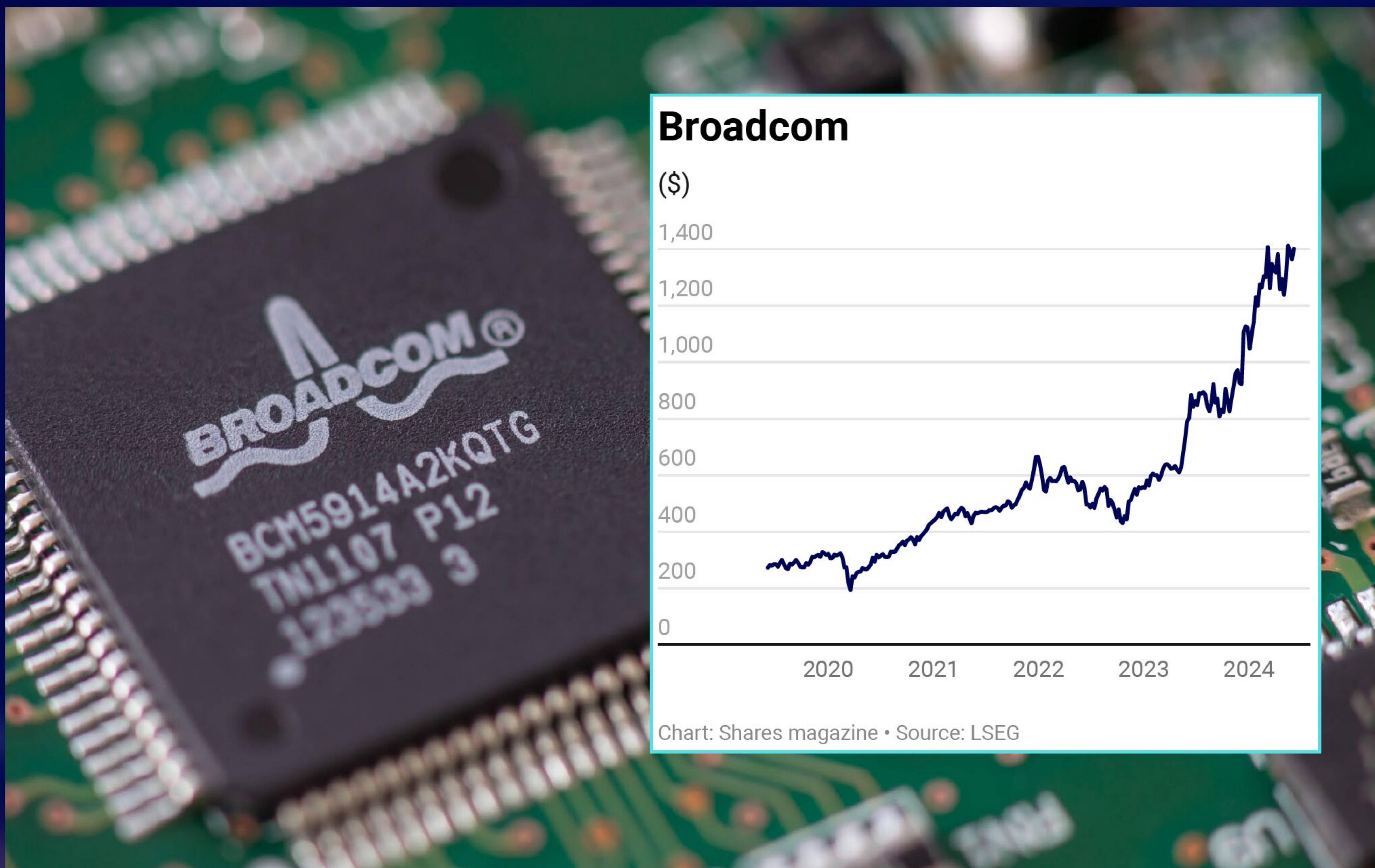
ETF/trust	Five-year annualised return	Ongoing charges
JPMorgan Global Growth & Income	15.5%	0.63%
iShares Edge MSCI World Quality Factor	13.0%	0.3%
iShares Core MSCI World	12.4%	0.2%

Table: Shares magazine • Source: Morningstar

sustainable debt levels (relative to cash generation). On market position, we like to find niche market leaders, with a strong economic moat which enjoy pricing power. Finally, we look for management teams with proven track records, skillsets and incentives that match the shape of our expected equity story. Quality for us is where all three elements come together – an attractive financial model, a strong market position and capable team.'

FOUR QUALITY PICKS

We used a mixture of our own knowledge and intuition and screening tools to identify four quality names which we think could reward shareholders over the long term. They span a variety of different sectors and countries and come from different parts of the market cap spectrum. Read on to discover our selections.



Broadcom (AVGO:NASDAQ) \$1,413.09

Ubiquity and quality are often pretty comfy roomies, so when your kit dominates the communications and connectivity world, investors should take note of **Broadcom (AVGO:NASDAQ)**. This is a Silicon Valley-based semiconductor and infrastructure software producer whose chips see an estimated 99% of all internet traffic pass through them.



It is also one of the world’s leading custom silicon developers, working closely with customers like **Alphabet (GOOG:NASDAQ)**, for example, to create application-specific chips that deliver superior performance and energy efficiency at lower cost for targeted workloads. On its infrastructure software side, Broadcom shuns the growth-at-any-cost approach and, according to **Blue Whale Growth’s (BD6PG78)** Stephen Yiu, chooses to work with its largest 600 to 700 customers to expand their use of its software, resulting in a highly attractive margin profile.

Gross margins run close to 70% and operating margins around 36%, although the later have been well over 40% in the past. Structural tailwinds behind the sector combined with the firm’s pragmatic business approach have led to years of superior returns – Morningstar calculates an average yearly return of 36% over the past decade, more than twice that of the Nasdaq. More of the same is anticipated, and by fiscal 2025 (to end October), net profit is seen roughly doubling 2023’s \$14 billion. This makes a three-year averaged forward PE (price to earnings) multiple of 25 look attractive, in our view. [SF]

DISCLAIMER: Steven Frazer owns a personal stake in Blue Whale Growth.

Gamma Communications
(GAMA:AIM) £14.70

Rallying 33% this year, **Gamma Communications (GAMA:AIM)** is, we believe, a unique play on integrated IT and communications on the UK market. Developing in-house designed, often bespoke kit using cloud technology helps organisations to get the best out of 21st century connectivity.

Shifting to cloud communications has been in play for several years but we think the pandemic hastened the shift for most organisations hoping to embrace greater flexibility and cost efficiency. Gamma already has significant scale, selling both direct to enterprises and through third-party resellers, and we would expect the company to continue expanding its offering, creating an increasingly compelling value and service-based proposition.

That it has a habit of out-competing both large and small rivals in what is increasingly known as the unified communications-as-a-service industry, or UCaaS for short, is additional proof of its quality credentials, but there is scope to improve returns on capital and equity (both high-teens) and operating margins (12.8% in 2023) back to previous peaks.

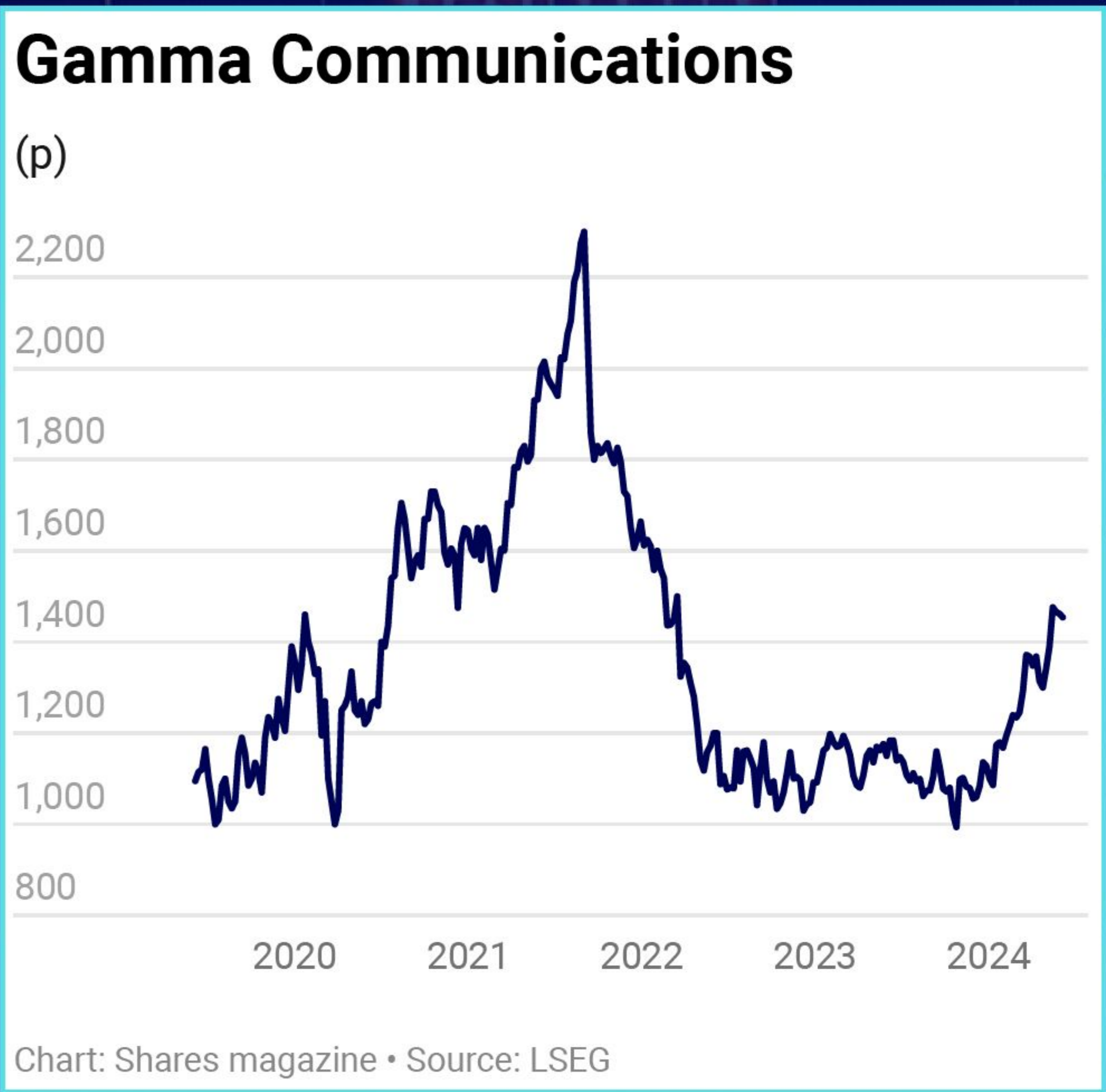
Gamma is a stock well known to *Shares* – we have



ROCE & ROE

A measure that is often employed by quality investors return on capital employed (ROCE). To generate value for its shareholders a business should be looking to generate a ROCE which is consistently ahead of its weighted average cost of capital (WACC). Translated into plain English this means it needs to make a bigger return on the money spent funding the business than the average cost of that funding (from both debt and equity). A good rule of thumb is that a ROCE of 15% or more is reflective of a decent quality business and this is almost certain to mean it is generating a return above its WACC. ROE (return on equity), calculated by dividing net annual income by shareholders' equity and multiplying the result by 100 to get a percentage, is a gauge of a company's profitability and its efficiency in generating its profits.

followed it right from IPO (initial public offering) nearly a decade ago, and were so taken by its sustainable quality growth and cash generation story that we made it one of our top picks for 2015. That was at 231.5p – it now trades 535% higher, so it's done quite well. But considerable further upside remains on the cards. [SF]



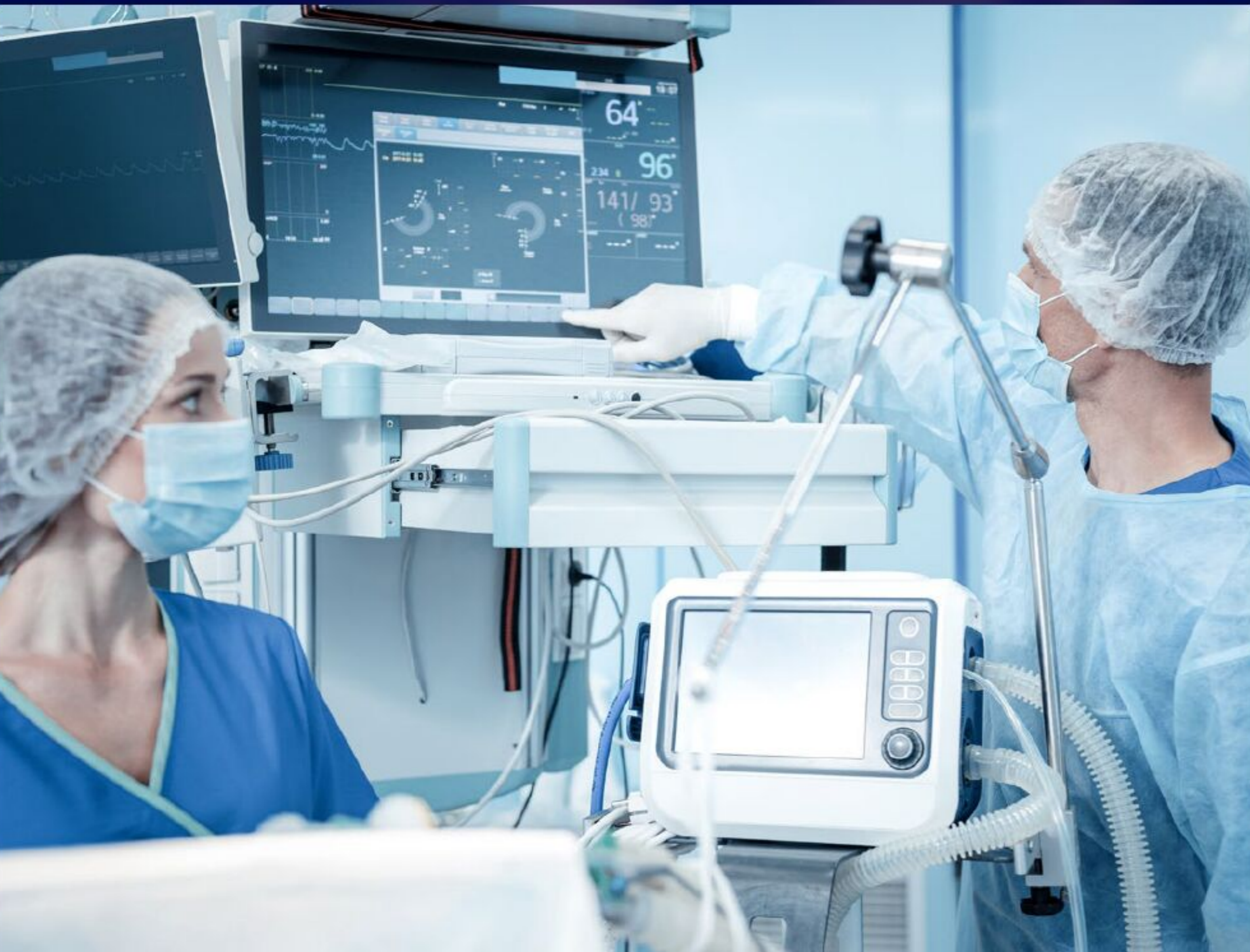
Tristel
(TSTL:AIM) 445p

Based near Cambridge, **Tristel (TSTL:AIM)** is a company focused on preventing the transmission of microbes from one object or person to another.

The company provides high level disinfection for medical devices used in non-invasive procedures such as ultrasound scans and sporicidal disinfection of surfaces.

Tristel has developed a patent protected proprietary disinfectant technology utilising chlorine dioxide. The company is unique in using its formulation as a high-performance disinfectant on medical devices via manual application of the chemistry.

This method eliminates the need for capital investment by hospitals in automated machines



Tristel

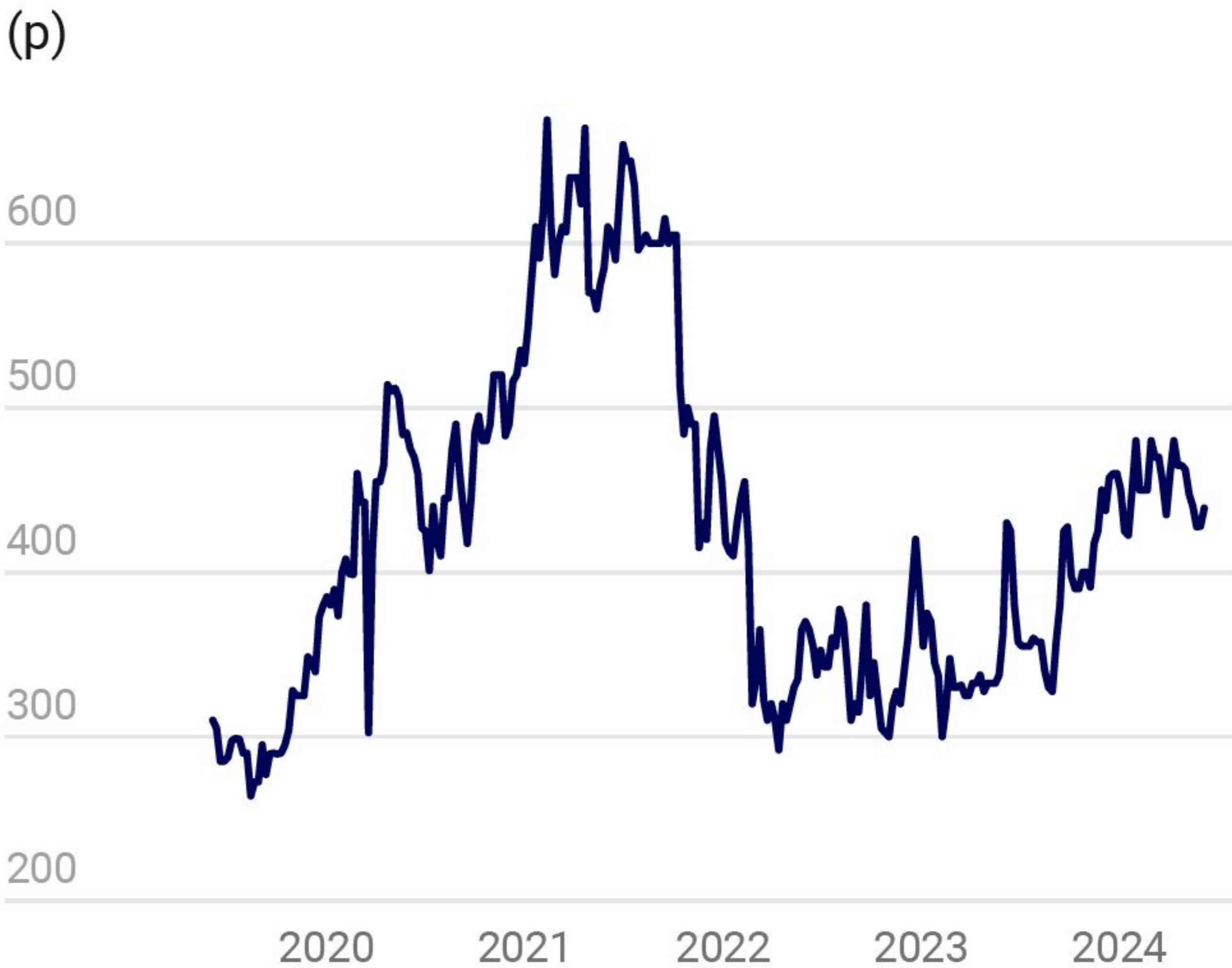


Chart: Shares magazine • Source: LSEG

to perform the same disinfection and requires no water or electricity, saving time and money. Tristel generates revenue from selling consumables.

Patent protection provides sustainably high gross margins of around 80% which translates into healthy returns on invested capital and strong cash flow generation (around 22% of revenue), all financial markers of a high-quality business. The company has net cash on the balance sheet.

In June 2023 the company secured US regulatory approval giving it access the world's largest market for ultrasound scans, underpinning its next leg of growth. The shares trade on a forward PE (price to earnings) ratio of 31 times, falling to 26 times for 2025. [MG]

QUALITY-FOCUSED COLLECTIVES

Other professionally managed portfolios with a fervent quality focus include **JPMorgan Global Growth & Income (JGGI)**, the popular investment trust whose managers look for the best companies wherever they are listed and focus on high-quality, cash-generative businesses which won't be knocked off course



by the economy or competitive forces.

Though he is currently licking his wounds following a period of underperformance, 'buy-and-hold' investor Nick Train's **Finsbury Growth & Income (FGT)** offers exposure to a concentrated portfolio of durable, cash generative companies with high returns on equity. And in the funds patch, **Blue Whale Growth's (BD6PG78)** global approach allows manager Stephen Yiu to look into every corner of the world for what he deems to be the best possible companies available.



Wolters Kluwer

(€)

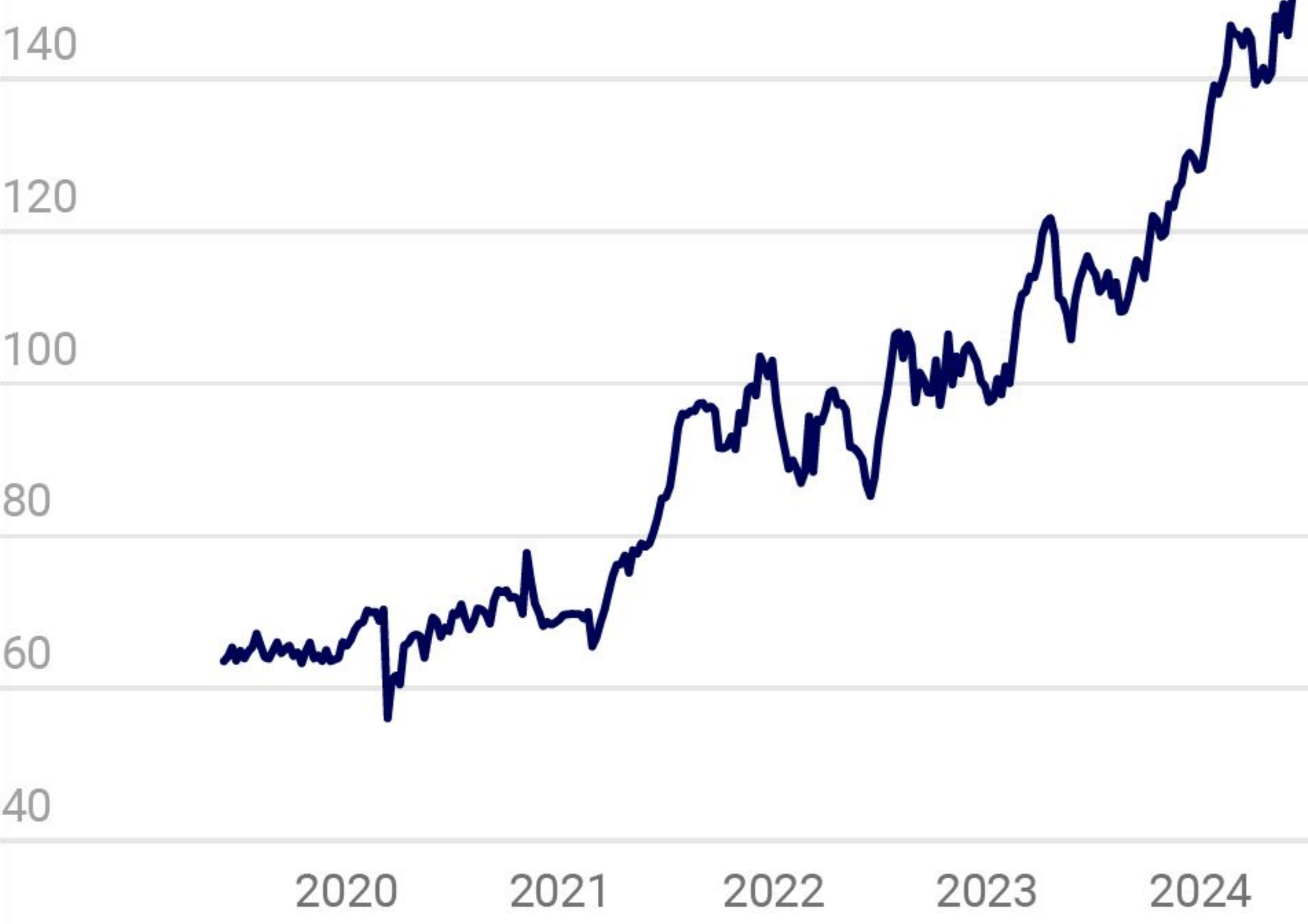


Chart: Shares magazine • Source: LSEG

Wolters Kluwer (WKL:AMS) €150

Dutch business services company **Wolters Kluwer (WKL:AMS)** provides information and software solutions to the legal, business, tax, accounting,



audit, risk, compliance and healthcare markets, making it something of a cross between data cruncher **Experian (EXPN)** and publisher **RELX (REL)**.

With a market cap close to €38 billion, it is one of the biggest quoted companies in Europe and a member of the Stoxx 50 benchmark.

The firm had a good start to 2024 with organic first-quarter sales up 6%, of which 82% came from recurring revenue, including a 16% increase in cloud software revenue.

For the full year, the company is expecting an operating profit margin of 26.4% to 26.8%, a return on invested capital of 17% to 18% and EPS (earnings per share) growth of mid- to high single-digits, all of which are highly respectable metrics.

The full-year earnings growth estimate tallies with our own work, which suggests that since the late 1980s Wolters has compounded EPS at around 9% per year.

That compares with just over 5% for RELX and around 7% for Experian, both of which trade more than one standard deviation above their 35-year average valuation on cyclically-adjusted earnings due to AI hype whereas Wolters – which is also an AI Player – is trading around its average. [IC]



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How ex-China ETFs have outshone broad-based emerging-market alternatives

Products carving out China have done better in recent years

A disappointing economic performance as it exited zero-Covid policies, a property crash in 2023 and ongoing geopolitical tensions with the US over Taiwan have caused some investors to lose faith in investing in China in the last couple of years.

In terms of ETFs, this has meant investors turning their attention to emerging market funds which specifically exclude the world’s second-largest economy from their asset allocation.

This would seem to be backed up by data from Morningstar Direct which shows ETFs with ‘ex-China’ in their title saw a notable increase in their total net assets between November 2022 and November 2023.

GOING ‘EX-CHINA’ DELIVERS IMPROVED RETURNS

An ‘ex-China’ emerging markets ETF does exactly what it says on the tin, providing exposure to emerging markets without including China.

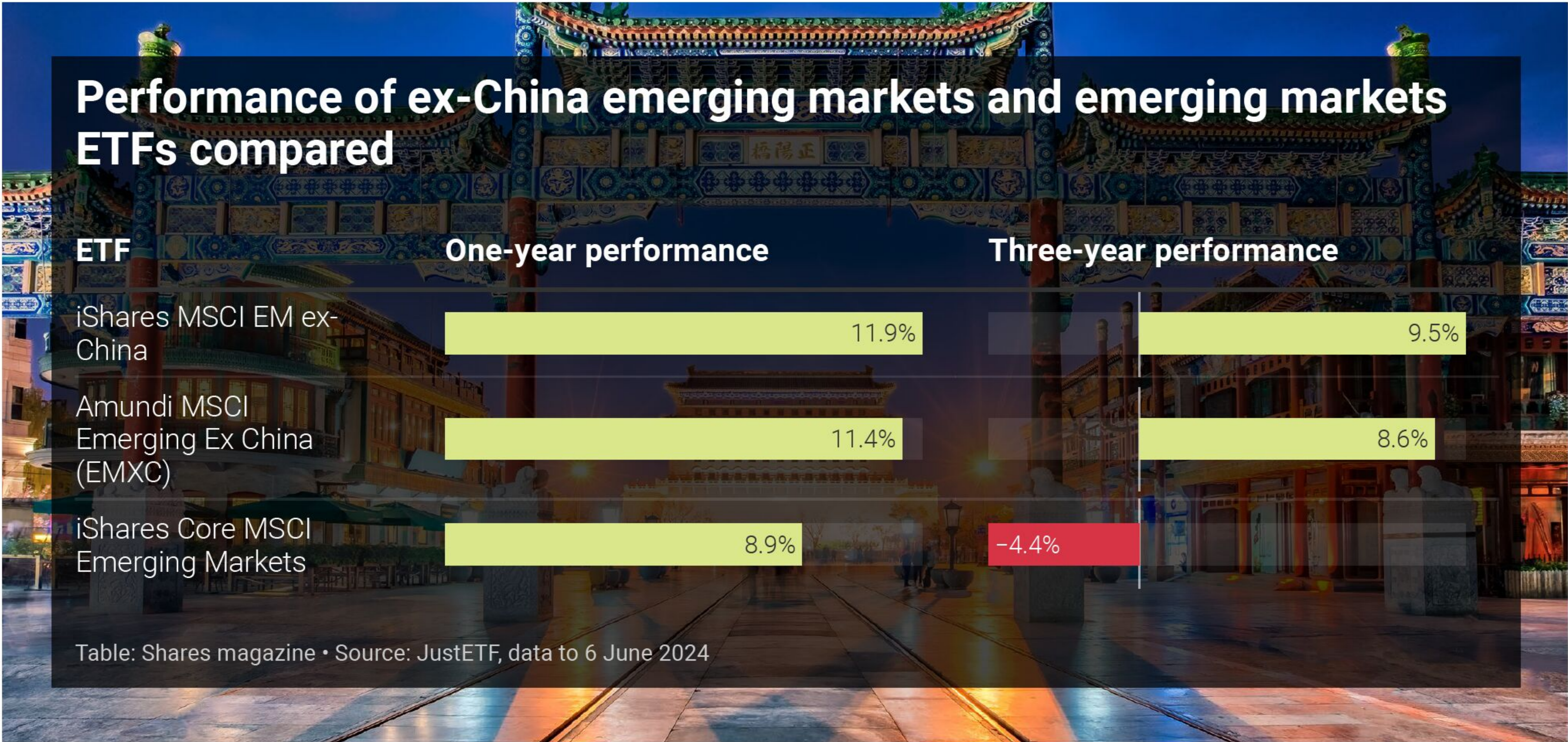
Over the course of the last three years, this



approach has delivered a superior performance compared to broad-based emerging-market ETFs which include a badly-listing Chinese stock market.

Over the past year, the iShares MSCI EM ex-China (EXCS) has returned 11.9% and cumulative returns over the last three years have been 9.5%.

Meanwhile, the Amundi MSCI Emerging Ex China UCITS ETF Acc (EMXC) has returned 11.4% over the past year and 8.6% over three years.



HOW DO MSCI EMERGING MARKETS AND
MSCI EX-CHINA EMERGING MARKETS INDICES COMPARE?

Apart from the obvious – i.e., the lack of Chinese exposure in one of these indices and the recent divergence in performance – there are some other notable distinctions between the two. Once Chinese names are stripped out, Taiwanese chipmaker **Taiwan Semiconductor Manufacturing Company (2330:TPE)** has a more dominant position in the index with a weighting in double digits in percentage terms. As the pie charts show, the ex-China index has a larger weighting to information technology and a significantly lower weighting towards consumer discretionary stocks relative to its counterpart.

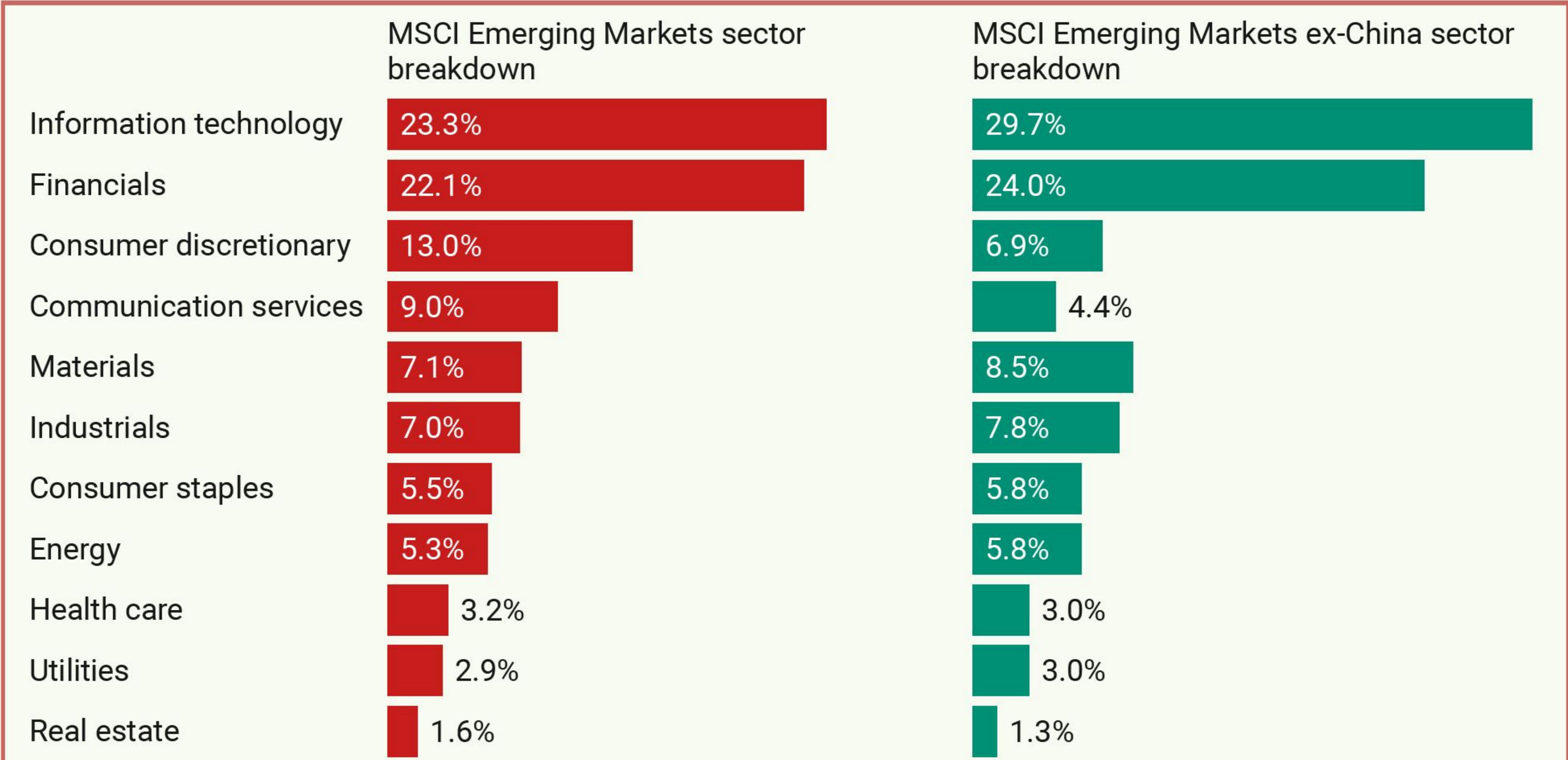


Chart: Shares magazine • Source: MSCI, data to 31 May 2024

In contrast, the largest broad-based emerging-market ETF, **iShares Core MSCI Emerging Markets IMI (EMIM)**, has chalked up an 8.9% return over one year and negative returns of -4.4% over three years.

POTENTIAL CHINA RECOVERY

Chinese markets have been showing some signs of recovery in recent months, so in the short term at least buying an ex-China emerging markets ETF would have diluted your gains. Over the past three months, the China-focused **HSBC MSCI China UCITS ETF (HMCH)** has returned 20.53%.

In the first quarter of 2024, China’s economy was stronger than expected due to growth in high-tech manufacturing, with GDP (gross domestic product) expanding by 5.3% on the same period a year ago according to the National Bureau of Statistics,

beating the estimate of 4.6% growth from a *Reuters* poll of economists.

Industrial output jumped 6.1% during the quarter as production of 3D-printing equipment, charging stations for EVs (electric vehicles) and electronic components all surged about 40% compared to a year earlier.

The Chinese government also recently announced a \$40 billion rescue package to help state-backed firms buy unsold properties from builders, sending the Chinese property sector index up 10% in a single day.

NOT IN CRISIS TERRITORY

Dina Ting, head of global index portfolio management at Franklin Templeton, says: ‘China’s stock market has certainly been battered, rattling



both consumer and investor confidence. But we wouldn't be so quick to categorise this disappointing stage as a crisis.

'Investors should still tread cautiously, of course, given Chinese consumers remain nervous about a still-shaky property market and high youth unemployment.

'But they should not completely write off the growth potential of China's domestic market—one arguably too big to ignore.'

Ting adds: 'Private investment in AI (artificial intelligence) and a tightening of the rules related to short selling are all attempts to restore investor confidence [in China].

'While investors do not expect a swift rebound in China's market, some are seeing alluringly cheap valuations as an attractive entry point to the world's second-largest economy.'

LONGER-TERM REASONS TO AVOID CHINA

Investors may still want the flexibility afforded to them by ex-China products for several reasons.

One is simply how dominant China is in emerging markets indices. In the MSCI Emerging Markets index, for example, China has a 27% weighting – nearly 10% more than India, the next largest market.

An ex-China ETF arguably represents a more diversified way of gaining exposure to the higher levels of growth from emerging markets – underpinned by more youthful populations and emerging middle classes.

Partly as a result of the one-child policy instituted in China between 1980 and 2016, China actually has population with an age profile more akin to the

WATCH THE COSTS

It is worth noting you may have to pay slightly more if you want an ETF which carves out China.

The iShares MSCI EM ex-China fund has the same ongoing charges figure as its mainstream emerging market product at 0.18%.

However, the Amundi MSCI Emerging Ex-China fund, while being slightly cheaper at 0.15%, is more expensive than the group's plain-vanilla emerging-market fund, **Amundi Prime Emerging Markets (PRAM)**, which has an ongoing charge of 0.10%.

West than other developing countries like India.

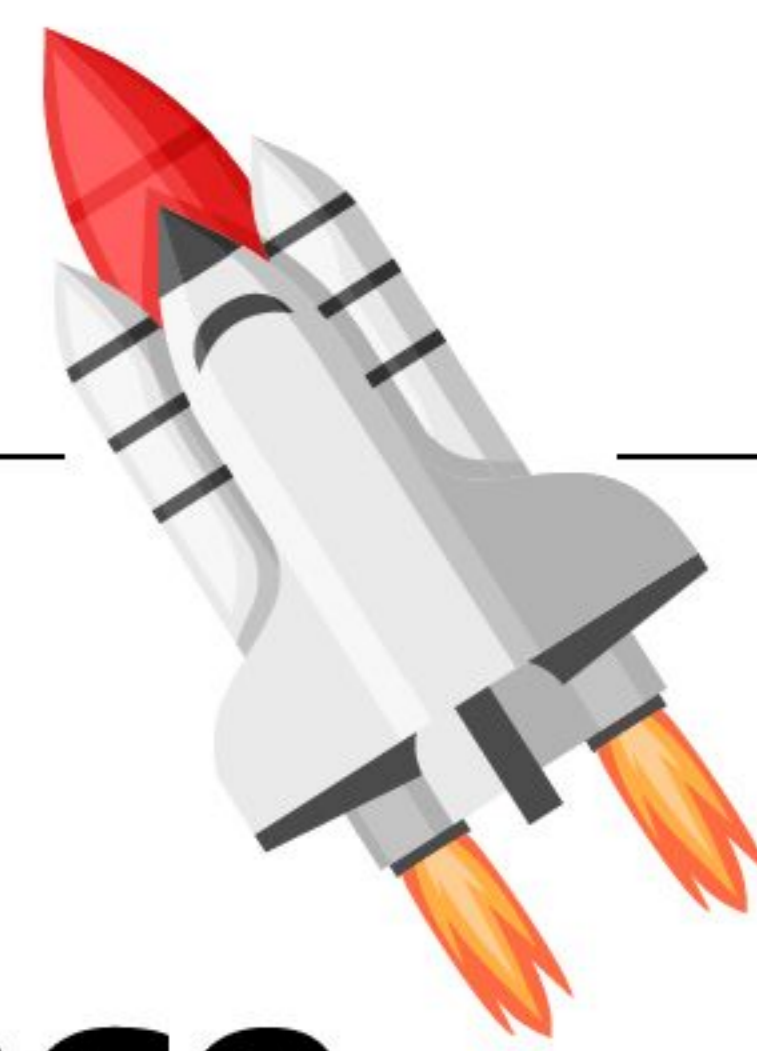
This brings with it challenges, notably a shrinking working age population being required to support a growing elderly subset and increasing demand in areas like health care.

Unlike other large emerging markets such as India and Brazil, China is not a democracy and has a difficult relationship with Western nations which brings with it layers of geopolitical risk, particularly over the thorny issue of Taiwan's nationhood.

Corporate governance standards, the transparency of company reporting and levels of government interference can be further hazards when investing in China.



By **Sabuhi Gard** Investment Writer



Investors turn their eyes to the skies again amid market space race

Boeing's Starliner launch, SpaceX's Starship's fourth test flight and Seraphim's share price rally draw attention

The space sector is gaining traction with investors again amid increased activity among names spanning US aircraft maker **Boeing (BA:NYSE)**, defence giant **BAE Systems (BA.)** and Elon Musk-backed SpaceX.

On 5 June Boeing launched its long-delayed astronaut capsule Starliner towards the International Space Station with two Nasa astronauts on board.

Butch Wilmore and Suni Williams – the astronauts in question – will be testing the capsule on a mission which is expected to last more than a week.

A day later SpaceX, which has been manufacturing and launching rockets and spacecraft for a decade, followed this by enjoying a successful launch with its huge Starship rocket at the fourth time of asking.

Back in February this year, defence giant BAE Systems completed the \$5.6 billion acquisition of Ball Aerospace which makes 'mission-critical space systems' and produces 'defence technologies across air, land and sea.' The deal was seen by analysts as a means of deepening BAE's relationship with Nasa.

These developments have refocused investors' attention on space-related stocks and funds like **Seraphim Space Investment Trust (SSIT)**.

Seraphim has gained 91% year-to-date – going from one of the worst performing investment trusts of 2023 to one of the 'best-returning' funds year-to-date 'by some distance' according to Liberum.

Notably the shares are still trading at discount from the IPO price of 100p, putting 2024's gains into perspective and highlighting this remains a nascent and higher risk area to invest in.

The company recently announced the sale of 100% of its interest in nine-early-stage portfolio companies to Seraphim Space Ventures II LP – a new venture capital firm managed by Seraphim Space Manager LLP.

The reasoning behind this is so the company can concentrate resources on 'more mature assets'.

Three of the trust's biggest holdings ICEYE, D-ORBIT and HawkEye 360 having closed sizeable

Seraphim Space Investment Trust

(p)



Chart: Shares magazine • Source: LSEG

new rounds of funding since the start of 2024.

Spire Global (SPIR:NYSE) has just entered into a multi-million-dollar deal with a financial firm to provide its high-resolution weather forecast model.

Spire has collaborated with **Nvidia (NVDA:NASDAQ)** to advance its artificial intelligence-driven weather prediction capability.

AST SpaceMobile (ASTS:NASDAQ) has also signed commercial agreements with both **AT&T (T:NYSE)** and **Verizon (VZ:NYSE)**.

Boggett tells *Shares* magazine a new growth area is the removal of space debris, repairing satellites and end of life care for satellites. 'A market that simply didn't exist five years ago,' says Boggett

One company that Seraphim invests in operating this new area is **Astroscale (186A:TYO)** which debuted on the Tokyo Stock Exchange on 5 June. The IPO raised circa \$153 million through a mix of primary and secondary capital.

Although the issue represented a circa 40% discount to the price of Astroscale's previous private financing round in the fourth quarter of 2023, the company traded up materially on the first day of trading.

Disclaimer: The author (Sabuhi Gard) owns shares in Seraphim Space Investment Trust.



By Sabuhi Gard Investment Writer



Three easy steps to assess a set of financial results

Find out the key details to focus on when a company posts its earnings

Staying on top of fundamental developments for companies in your portfolio can seem like a daunting task. Share prices can be volatile around earnings reports and trading updates, so getting to grips with what has happened and why is an important part of successfully managing investments.

This feature reveals three simple steps to demystifying a typical earnings report and getting a good steer on why a share price has moved in a particular direction.

Before starting it is worth emphasising that any report, whether annual or quarterly is merely a snapshot of how a company has performed over a very short period.


It is therefore important to apply some perspective. Long-term investors expect to hold shares for many years and to benefit from the growth of the business and associated cash flows, profits and dividends. In other words, a single earnings report is best viewed in the context of the bigger picture.

The bigger picture begins with the corporate strategy a company has employed to achieve its financial goals. An earnings report is therefore

primarily an opportunity for investors to find out how the business has been performing against that strategy. It is also an opportunity to hold management to account.

WHAT IS ALREADY BAKED IN?

Step one is to discover how the business has performed relative to what was expected. This is important because markets are forward looking



THREE THINGS TO LOOK FOR IN EARNINGS REPORTS

1. How do earnings compare with expectations?
2. What is the outlook?
3. How much profit converts into cash flow?

Dr Martens



- 1 30 Nov – Weak third-quarter sales trigger profit warning
- 2 16 Apr – Profit warning and CEO exit
- 3 30 May – Shares rally on US recovery hopes and cost-cutting plans

Chart: Shares magazine • Source: LSEG



which means share prices discount what investors expect to happen. Note, this means share prices can move up on bad news and down on good news.

A good example is iconic footwear brand **Dr Martens (DOCS)** which on 30 May 2024 posted a 43% slump in annual profit. The shares rallied as much as 6% on the day because investors focused on the cost cutting announced and increased investment in marketing aimed at boosting sales.

Other contributing factors here are the several profit warnings issued over the last year which have resulted in downtrodden expectations going into the results.

So where does an investor find out what is expected? Helpfully, some UK companies provide consensus expectations either on their website or reference them in the earnings release.

For example, pet care specialist **Pets at Home (PETS)** included a reference to market forecasts in its first-half results released on 24 May 2024: ‘We are comfortable with current analyst consensus for financial year 2025 underlying pre-tax profit, currently circa £144 million.’

Failing that, free resources are available including Marketscreener and Nasdaq.com for US firms. Paid for resources include financial software providers such as Stockopedia and SharePad which give consensus sales and profit forecasts. *Shares* also regularly previews big earnings releases in our *Week Ahead* section.

The extent of an earnings beat can be significant because it can lead to upward analyst earnings revisions which can be a powerful driver of stock returns.



Therefore, getting a good sense of the likely move in earnings estimates, post results can be very valuable. *Shares* provides analyst comments and views while paid-for retail platforms such as Research Tree provide some access to analyst reports.

Step two is to read the outlook. A positive outlook is often found near the top of an earnings report while a negative one can sometimes be harder to find because the company's public relations team have hidden it away near the bottom of the report.

The important takeaway here is that the outlook statement can often trump a positive earnings beat, which can sometimes catch investors off guard. There is some logic to this in that, investors place more weight on future earnings beats than past ones.

In general, shares in companies which upgrade the outlook on the back of a better-than-expected earnings release do better than those which do not.

An example is US retailer **Dick's Sporting Goods (DKS:NYSE)** which on 30 May 2024 reported better than expected first quarter sales and EPS (earnings per share) prompting management to raise full year profit guidance above consensus estimates, sending the shares 16% higher.

HOW MUCH PROFIT WAS TURNED INTO CASH FLOW?

Step three is to find out how much profit was converted into cash flow. At the end of the day cash flow is more important than earnings. A typical way of measuring this is to compare cash generated from operations (found in the cash flow statement) with operating profit.

More and more companies calculate their own APMs (alternative performance measures). For example, the Martens calculates operating cash flow by starting with EBITDA (earnings before interest, tax, depreciation, and amortisation) and then deducts movements in working capital, share payments and capital expenditures.

The company converted 79% of EBITDA (£197.5 million) into operating cash of £156.8 million. The company says this is in line with guidance.

Every firm will target a different conversion ratio, and it is worth keeping a close eye on the trend in the conversion ratio over time. The higher the ratio the better the quality of those earnings.



PULLING IT ALL TOGETHER

A key question for investors following an earnings update is to establish how well the business is performing against expectations and the strategic plan. Is the business falling short or gaining momentum?

How do earnings compare with the trend over the last five years and are there any signs of acceleration or deceleration? Finally, try to place the latest update in the context of the bigger picture and long-term investment thesis. Bear in mind not all successful investments progress in a smooth linear fashion.

What should be a prompt for a revaluation of a stock's place in your portfolio is any sign of unexpected shift in strategy which brings with it additional risk or indications it is facing new structural problems which could put earnings under pressure.



By **Martin Gamble** Education Editor



Come back Sir John Barnard, all is forgiven

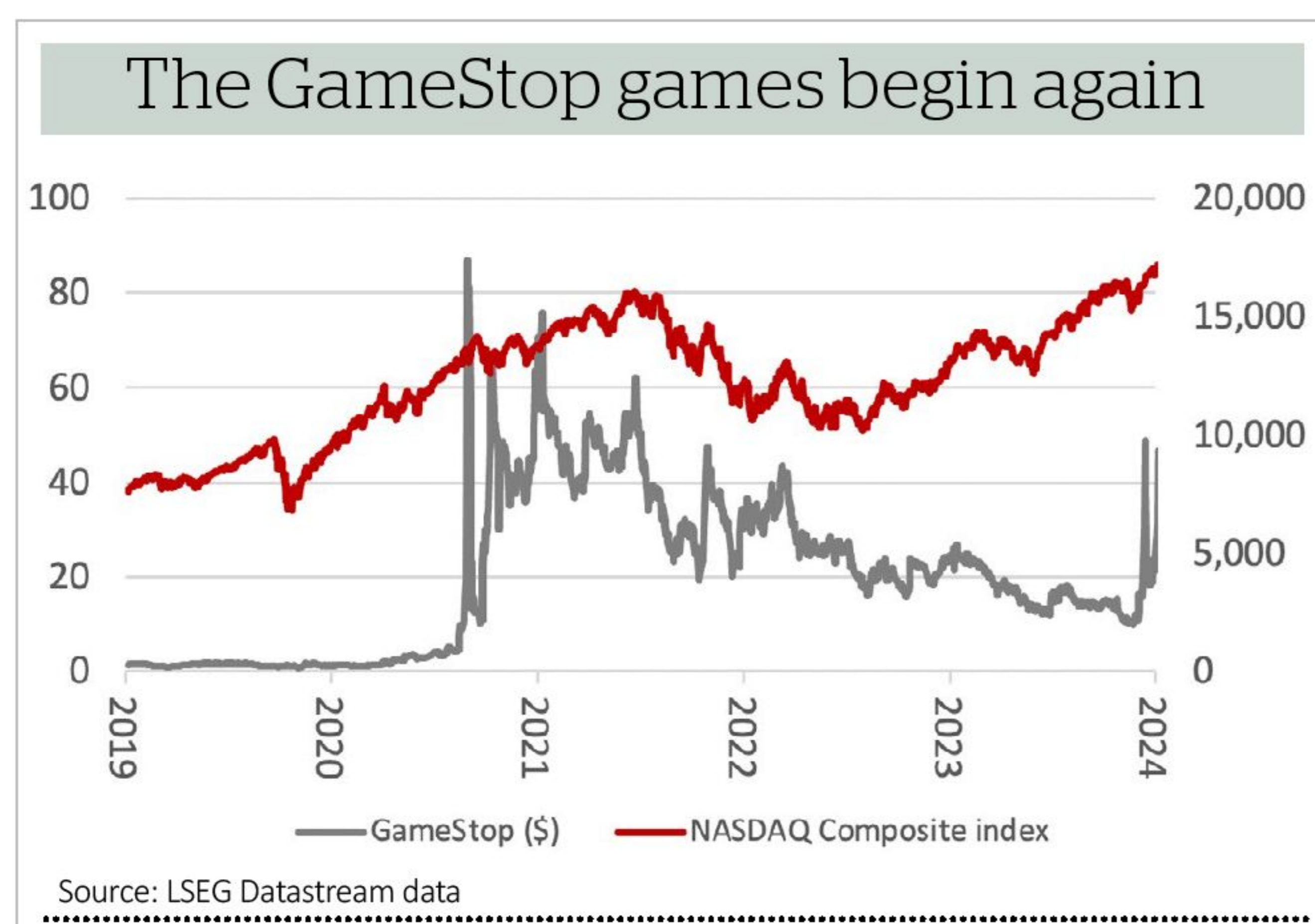
Buoyant markets may be underpinned by margin debt in the US

Here we go again. Shares in **GameStop (GME:NYSE)** are surging, US equity markets are setting new highs and a lowly reading on the VIX index suggests investors are confident that volatility will remain low and equity markets buoyant.

This is all barely three years after the year GameStop melt-up (and, lest it be forgotten, subsequent melt-down), which also saw social media influencers and commentators stir interest in a range of meme stocks, including **AMC Entertainment (AMC:NYSE)** and even silver (which seems to now be doing rather well despite the Reddit crowd's apparent loss of interest in the commodity). The last meme stock surge did not last long and, it could be argued, presaged 2021-22's nasty correction in risk assets.

DEVIL MAY CARE

Benjamin Graham, Warren Buffett's mentor, argued that the best long-term investment returns were reaped by realists who bought from pessimists and sold to optimists. You can argue that the short squeezers are at least buying from pessimists when it comes to GameStop but may be that more than a few optimists are piling in now, hoping to ride the share price momentum to a quick gain.



Such a devil-may-care attitude to risk can lead to trouble and the precedents are clear to see in the overheated markets seen in the late 1920s and late 1990s and (to a lesser degree) the mid part of the first decade of this century. They all ended in tears and big market setbacks which hurt a lot of investors, traders and ultimately did damage to the wider economy, as money was misallocated and squandered.

Perhaps we should therefore all be heeding the warning of economist (and stock market investor) John Maynard Keynes when he said, 'When the capital development of a country becomes the by-product of a casino the job is likely to be ill-done.'

TRIGGER MORTIS

Quite what the plan of the latest round of GameStop buyers is remains to be seen, but previous efforts to squeeze short sellers in this stock ultimately failed and it is hard to push around the price of a security or asset on a sustained basis, for three reasons.

- The best cure for high prices is high prices. In the end some traders somewhere are going to want to take a profit on GameStop and someone is going to left holding the bag – at least one unfortunate person must have paid the top tick in GameStop at around \$470 and be sitting on a loss.
- All short squeezes or ramps have an element of a pyramid scheme about them as they need new money coming in to maintain the upward price momentum (and also give early movers a chance to book their profits and move on), so ultimately you start to run out of (other people's) money.
- If none of that works, the regulator can take umbrage and get involved. This is what happened when the Bunker Hunt brothers tried to corner the silver market in the last 1970s, although the authorities only tend to get involved once the bubble has burst, and heavy losses, financial distress or wider market or economic turmoil have resulted.



The collapse of the South Sea Bubble in 1720 eventually germinated Sir John Barnard's Act in 1734, which outlawed both short selling and the use of derivatives products such as futures and options (and was only repealed over 200 years later). Similar responses followed the 1929 Wall Street Crash, in the form of the Glass-Steagall Act, and the 2007-09 Great Financial Crisis, with Wall Street Reform and Consumer Protection Act (or Dodd-Frank, as it is more commonly known). The theme across all three acts was limits to use of derivatives and leverage.

FOREVER AND A DAY

However, the use of margin debt continues to flourish in the US, even if overall levels are still slightly below their record highs.

That could be helping to fuel markets now, but history shows that confidence soon evaporates if the market stumbles and history suggests the liquidation (forced or voluntary) of positions bought on margin accentuate any subsequent market decline.

It is here that the greatest dangers may lie today, in these over-the-counter, lightly regulated, trillion-dollar markets which are funded by leverage. Financial innovation, coupled with central-bank provided liquidity, is creating trouble and eroding the stability of financial markets, which have blundered from one crisis to the next with ever-greater regularity in the last 30 years – from Orange County to the Tequila Sunset to Barings to the Asian currency crisis to the Russian debt crisis and LTCM to the tech bubble to the

... and this leverage has a record of accentuating market swings

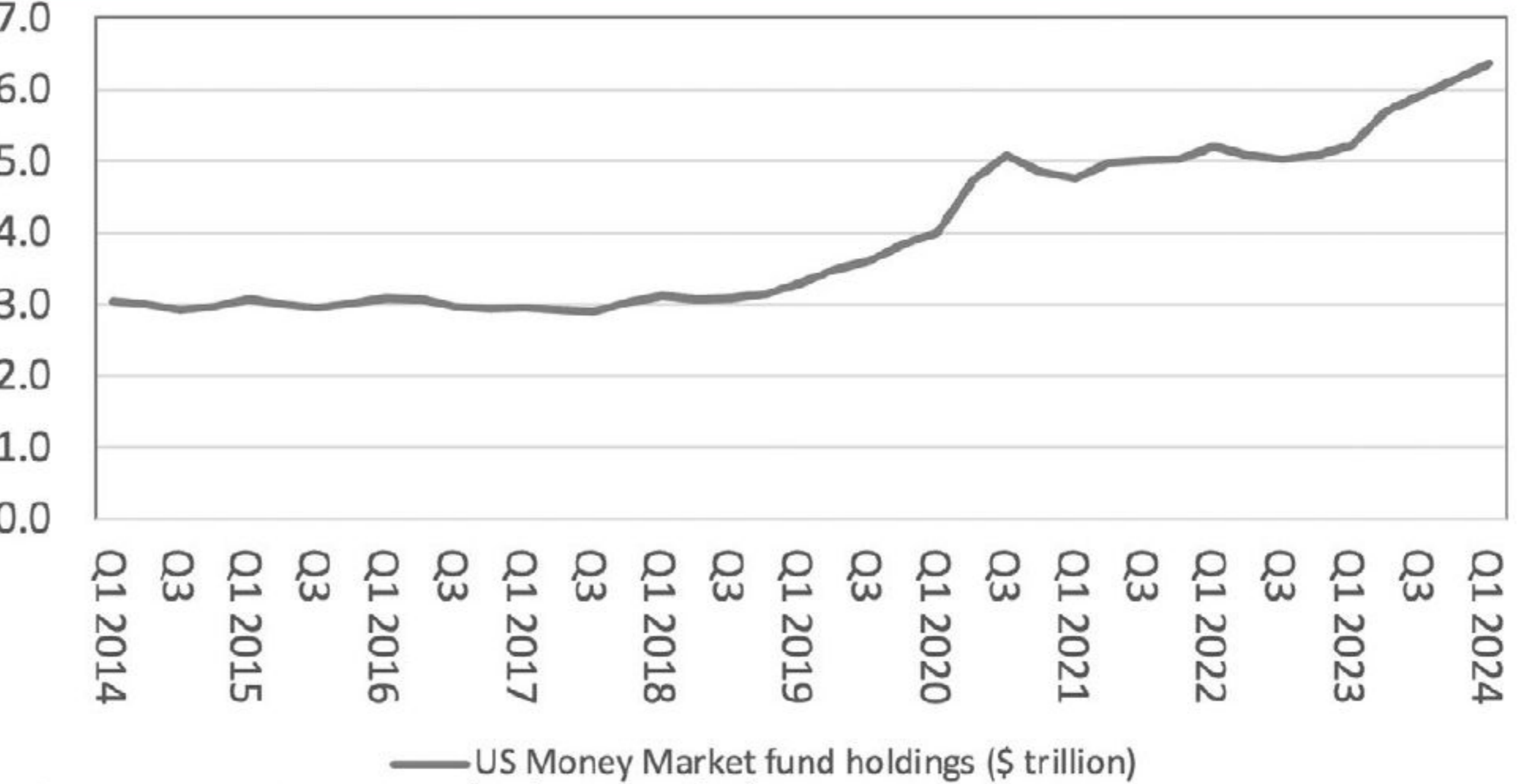


Source: NYSE data to February 2010, FINRA data from February 2010. LSEG Datastream data

mortgage securities bubble and the Big Short and beyond.

Central banks have a very difficult balancing act ahead of them, as they try to what they feel is right for the real economy without handing out too much rocket fuel to financial markets. It can be argued that fifteen years of zero interest rates and quantitative easing (plus surging house, stock, bond and asset prices) mean the economy is excessively liquid, and the prospect of the Fed cutting interest rates when there is \$6.4 trillion sitting in US money market funds, ready to look for a new home, may just have students of stock market bubbles reaching for their history books.

US money market fund balances sit at an all-time high

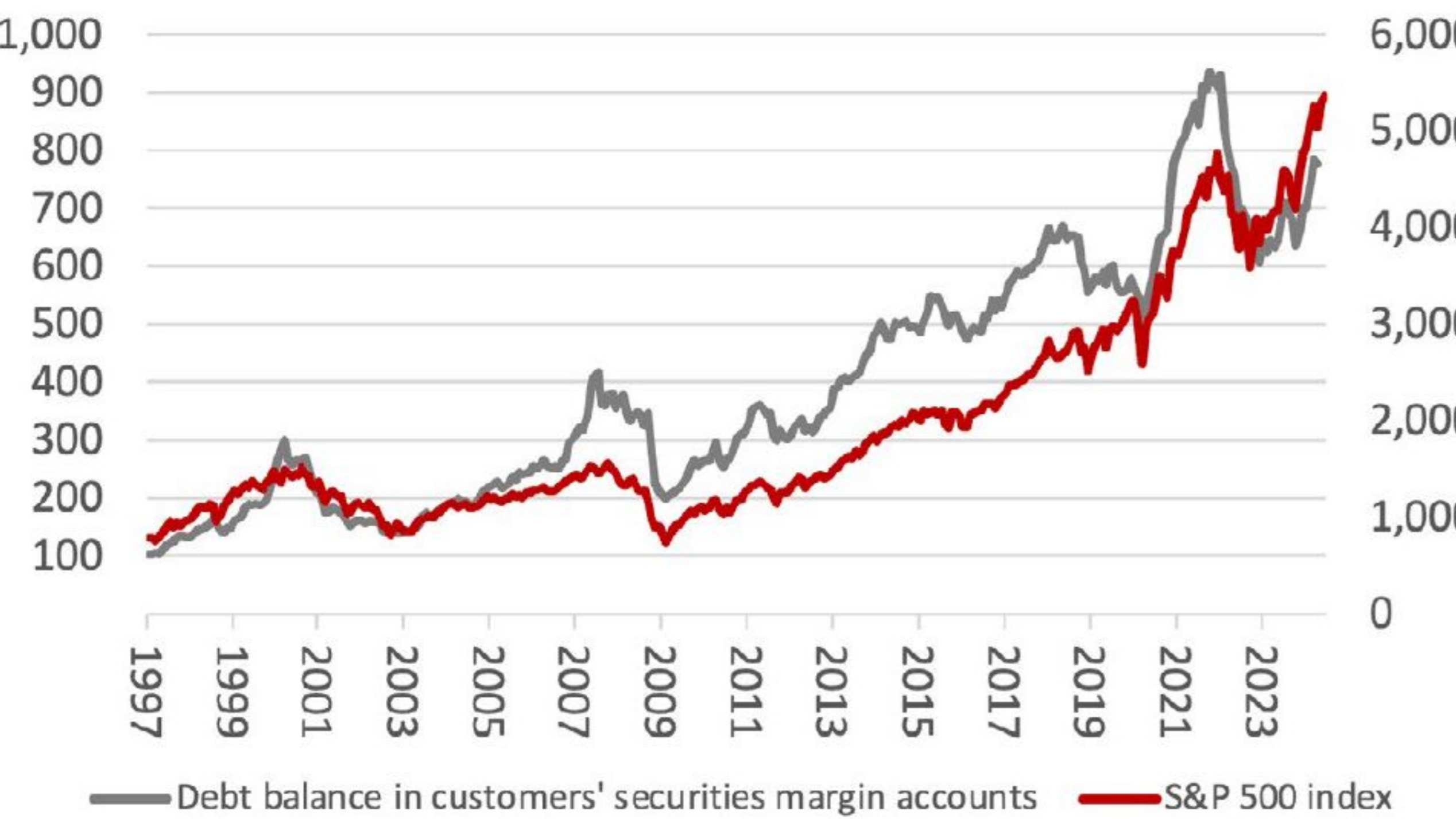


Source: FRED – St. Louis Federal Reserve database



By Russ Mould
AJ Bell Investment Director

Margin debt is piling up again



Source: NYSE data to February 2010, FINRA data from February 2010. LSEG Datastream data

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Is AI causing a bubble in the markets?

There are risks but also at least a couple of reasons to think irrationality has not completely taken over

The long-awaited announcement of **Apple's (AAPL:NASDAQ)** artificial intelligence (or should that be Apple Intelligence) proved something of a damp squib as far as the market was concerned. By effectively outsourcing the job to OpenAI and ChatGPT it almost feels like the company is admitting it has been left behind in the clamour for AI. But is AI creating a bubble in financial markets? Bank of America analysts suggest it is at least a risk. 'The question is can we incorporate AI into the economy without an asset bubble ensuing? It may be hard to avoid given the likely significant but unclear way in which AI will impact the global economy, not dissimilar to the internet in the '90s or railroads in 1840s Britain. The dominance of price momentum, investors remaining believers in buying equity dips, and meme stock popularity only add to the potential for irrationality.'

However, their work implies we're not at this point with an insufficient pick-up in the volatility which they flag as a necessary precursor before a bubble reaches full frenzy.

To get a sense of whether irrationality is taking over this author conducted his own crude exercise – looking at the performance of all the US companies with AI in their name.

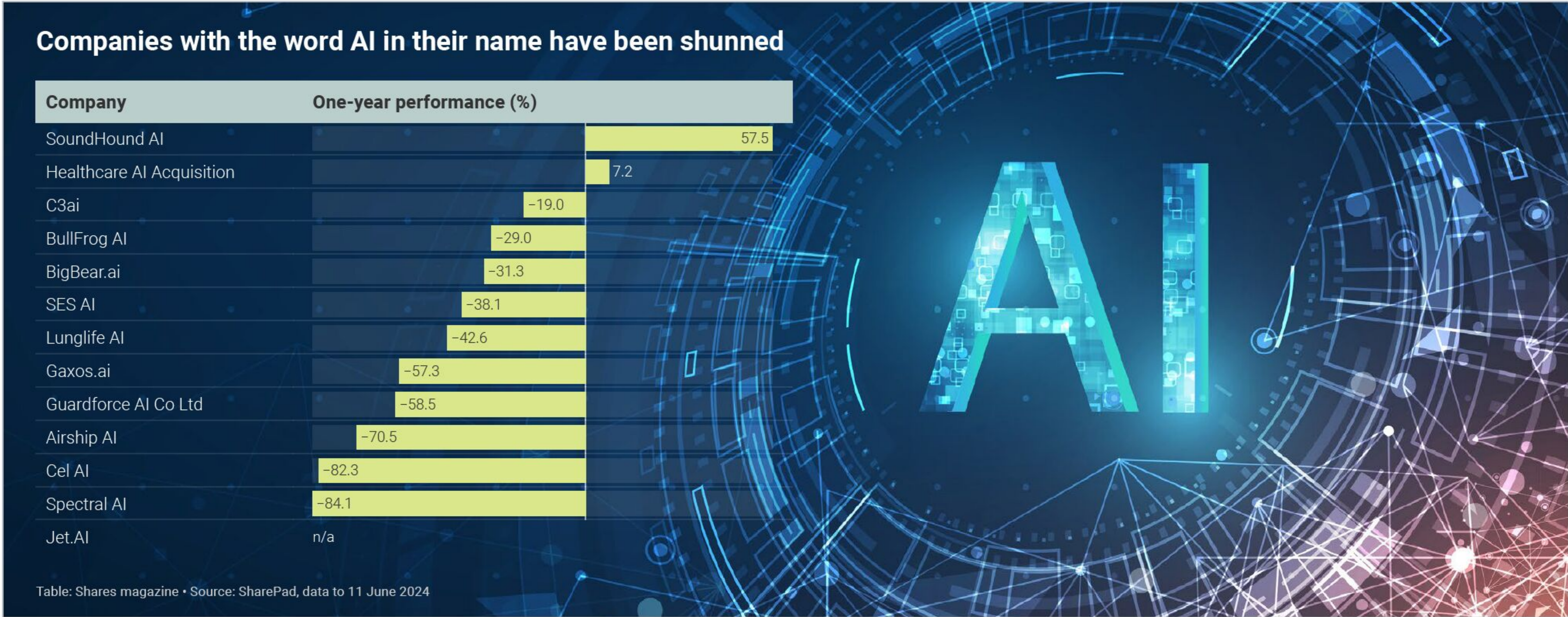
Adding AI might be appropriate in some cases but there could also be an element of cynicism at play – looking to hook in investors aiming to gain exposure to the hottest new theme. Frankly on this basis it's almost a surprise there aren't more examples.

By our reckoning there are 12 such firms listed in the US and two in the UK. Most of these names are not profitable but, if we're in an AI-driven bubble, investors might not be too discriminating.

Examining their performance over the last 12 months when AI has increasingly moved into the mainstream, most have stunk the place out suggesting we're not at the Dutch tulip mania stage yet.

The Financial Conduct Authority is set to meet on 27 June to approve the final version of the new listing rules which are intended to help revive the fortunes of a struggling UK stock market.

The announcement of the new regulations is not expected until after the election on 4 July but hopefully there will be no major watering down of governance standards. As we've observed before this is likely to do very little for London's reputation as a listing venue in the long term.





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The real losers from frozen tax allowances

Working out who’s been worst affected by the lack of movement on these thresholds

The Conservatives fired the starting gun in the election campaign on personal tax, pledging to uprate the personal allowance for pensioners using a ‘quadruple lock’. This was quickly followed with confirmation that personal tax thresholds and allowances for working people would remain frozen until 2028. Labour has also hinted it would not end the freeze on allowances, nor would it raise tax rates.

IF ALLOWANCES HAD NOT BEEN FROZEN
The OBR estimates that by 2028-29, we will see

almost four million extra taxpayers – that is 2.7 million more moved to the higher rate of income tax, and another 600,000 paying the additional rate. These numbers would be a bit lower if the Conservatives won and introduced the quadruple lock for pensioners, but working age people would still be feeling the effects of ‘fiscal drag’.

Most people have a tax-free personal allowance of £12,570, with income tax of 20% payable on the next £37,700, meaning a higher rate threshold of £50,270. If the allowances had increased with inflation, they would be over £15,000 and £60,000 now respectively.

What if allowances had been linked to inflation?

Year	Inflation rate	Personal allowance	Higher rate threshold
2021/22	3.1%	£12,570	£50,270
2022/23	10.1%	£12,960	£51,828
2023/24	6.7%	£14,139	£56,545
2024/25	0.8%	£15,171	£60,673
2025/26	1.5%	£15,505	£62,007
2026/27	1.6%	£15,737	£62,937
2027/28	1.9%	£15,989	£63,944

Inflation rate taken from March 2024 OBR report based on actual figures for all available and then forecasts for future years. In practice, personal allowance and income tax thresholds are typically rounded to the nearest £10 or £100.
Table: Shares magazine • Source: AJ Bell

Salary at start of 2021/22	Total tax due under frozen allowances (2021/22 to 2027/28)	Total tax due under inflation linked allowances (2021/22 to 2027/28)	Extra tax due under income tax threshold freeze
£25,000	£24,244	£21,428	£2,816
£35,000	£40,981	£38,165	£2,816
£50,000	£79,447	£65,368	£14,079
£75,000	£163,077	£148,998	£14,079

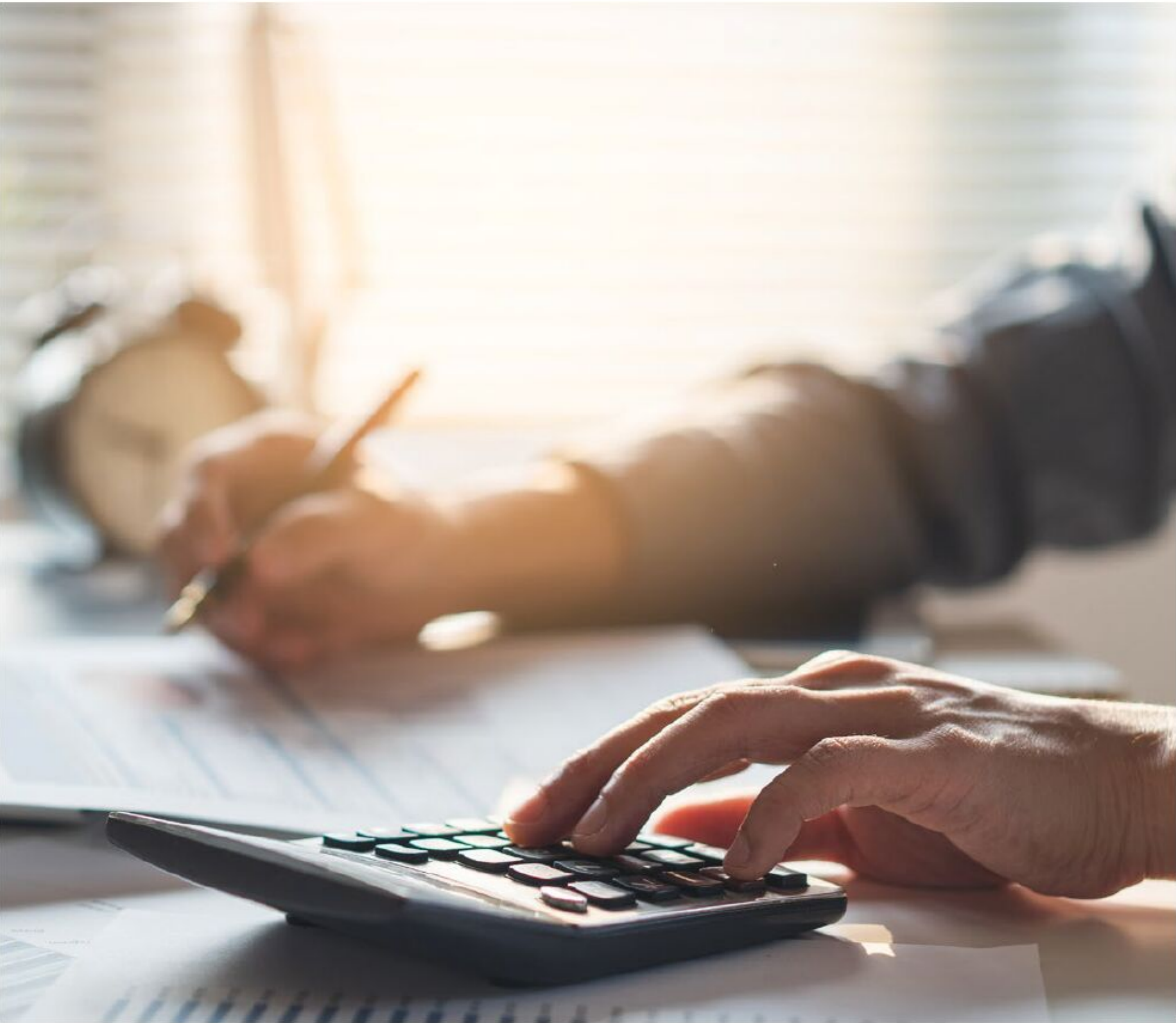
Inflation and wage growth rates taken from March 2024 OBR report
Table: Shares magazine • Source: AJ Bell

EXTRA TAX PAID
Someone earning £50,000 back in 2021 would expect to be on £67,314 by 2028, according to actual and forecast wage growth figures from the OBR. This would mean they will expect to pay income tax of nearly £80,000 by 2028 with frozen allowances, £14,000 more than they would have likely paid if allowances had been uprated with inflation.

You can see the impact for range of earnings in the table.

WHAT CAN PEOPLE DO ABOUT FROZEN BANDS
For those that can afford to, pension contributions can help lower your adjusted net income and potentially bring you into a lower tax band, with the bonus of boosting your retirement savings.

This is particularly useful for people in ‘tax traps’ created by quirks in the tax system. Examples



include the child benefit tax trap for people earning between £60,000 and £80,000 or those who start to lose their tax-free personal allowance and parent who lose all extra childcare funding where adjusted net income is over £100,000.

While improvements have been made to the child benefit thresholds, the adjusted net income limit for losing the personal allowances has been frozen since April 2010.

For example – someone who earns £100,000 and gets a pay rise of £10,000 will pay income tax of £6,000 on that £10,000 – that is 40% on the £10,000 plus another £2,000 thanks to the loss of £5,000 personal allowance.

Factor in lost tax-free childcare for two children (£2,000 each) and the value of free funded hours (around £3,250 a year per preschool child) and that pay rise has lost them more money than it is worth.

By paying £8,000 net into a pension, they will end up with £10,000 extra saved towards retirement thanks to automatic basic rate tax relief, another £2,000 back in higher rate tax relief via self-assessment, plus the value of the extra childcare back.

Disclaimer: Financial services company AJ Bell referenced in the article owns Shares magazine. The author of the article (Charlene Young) and the editor of the article (Tom Sieber) own shares in AJ Bell.



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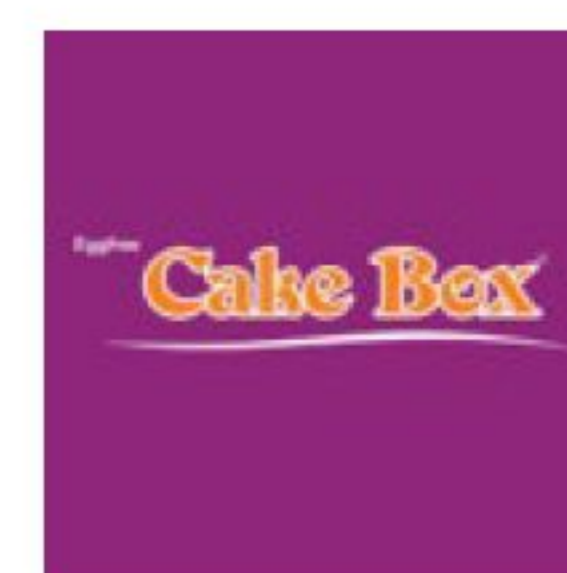


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I want to leave funds in my SIPP to my granddaughter how do I go about it?

Answering a question about how to pass on money in a pension pot

I'm currently 70 years old and intend to leave whatever is left in my SIPP to my granddaughter who is 17 years old.

What are the current regulations regarding at what age she would be allowed to access the money, and is there any method to ensure it stays invested until she is of pensionable age?

John



Rachel Vahey,
AJ Bell Head of Public Policy, says:

Pension savers have a lot of flexibility to decide who to leave their pension fund to. But as with many elements of pensions, the rules can sometimes be quite complicated.

Pension money is usually held within a discretionary trust. This means the trustees or scheme administrator is responsible for the money and must make decisions in the best interests of the pension scheme members.

The final decision of who receives the pension pot when a member dies rests with the trustees or scheme administrator. However, pension savers can make their wishes known and nominate anyone they want to have the pension funds when they die.

DEPENDANTS NEED TO BE LOOKED AFTER

When paying out the money the trustees want to make sure any dependants of the member are financially looked after. Usually, they would be inclined to pay out to a spouse or partner living with the member. (And this usually matches the nominations people make – most want to make sure their loved ones have enough money.)



A pension saver could, however, nominate someone else to inherit the funds, for example children or grandchildren. The trustees or scheme administrator would then consider that person. If the pension saver still has a dependant living, then the trustees or scheme administrator will want to make sure that person will have enough money from other sources to live on. It's important in this situation to give the trustees or pension scheme sufficient information to help them make this decision.

When someone inherits the pension fund from a SIPP, they may be able to access the funds by taking a lump sum, buying an annuity to give themselves a guaranteed income for life, or they could move the money into drawdown and take the money out gradually to suit their needs or leave it to continue investing.

A nominee or dependant inheriting pension money gets the money straightaway – they do not have to wait to reach age 55 or 57. However, if younger children inherit the funds, they could be kept in a pension with their legal guardian controlling investments and withdrawals until they turn 18.

However, a pension saver could consider setting up a 'bypass' trust to add some rules or control over who inherits the pension money, how they can take it and when.



MAKING A NOMINATION

The pension saver nominates the trust to receive their pension as a lump payment on their death. They choose the trustees and can give them clear instructions which are more nuanced than pensions allow. For example, they could say pay out an income rather than a lump sum, or put a minimum age for the beneficiary to access the pot.

If the pension saver dies after age 75 there will be a 45% tax charge when the pension pot is paid to a bypass trust, although the beneficiary may be able to claim some or all of this back when they receive income from the trust. Before age 75 it will be tax free if the pension saver has enough remaining lump sum and death benefit allowance and paid within two years of the pension scheme being told about the pension saver's death.

Anything over will be taxed at the trust tax rate.

When the benefits are paid out, they will be tax free if the pension saver died before age 75. Otherwise, the payments from the trust will be added to the beneficiary's income for tax purposes. If 45% tax was deducted this can be used to offset any income tax due.

There may be IHT charges on every 10-year anniversary of the trust (the periodic charge) or whenever property leaves the trust (the exist charge). The working out of these taxes can be very complex. And there are other tax considerations to bear in mind as well.

It's for these reasons, individuals considering a bypass trust need to take care. Although they can exert extra control, that comes with additional costs and taxes. Anyone thinking about this should seek specialist advice.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

Please note, we only provide information and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

Questions about retirement?

Rachel Vahey, AJ Bell Head of Public Policy, is here to answer your questions

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Ask
Rachel



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