THE SMALL COMPANY

SHARE WATCH

October 2022

MARKET COMMENT

WARPAINT LONDON (W7L)

Sector :	AIM, Personal Goods	
Latest Price :	xxp	
High/Low :	187p - 105p	
Market Cap. :	£xxm	
Shares in issue:	77m	
end12/2022 EPS/PER est	9.4p	xx
end12/2023 EPS/PER est	9.9p	xx
end12/2024 EPS/PER est	10.6p	xx
Telephone	01753 639 130	
Registrars	01215 851 131	
CALENDAR		
Int/Fins/AGM	SEP/APR/JUN	

Warpaint London is a UK-based specialist cosmetics merchandiser, which comprises two divisions - first, its own-brand beauty products, principally the *W7* and *Tecnic* brands and second, the much smaller close-out division. I first recommended the shares in January '17 at 137.5p. After going to 295p in five months, GP3 sold out at 267.5p - quite fortunate in timing as just a month later, Warpaint warned on profits.

But now, four years later, the company has found its second wind. During the month I met again with co-founders Sam Bazini and Eoin Macleod, and finance director Neil Rodol. Not only has Warpaint been spreading its wings overseas but its affordable prices leave it well placed for tougher economic conditions and sales are surging. This surge in sales is good news for Warpaint because of the high gross margins on its branded product range and the largely fixed-cost nature of the business - £3m extra in sales translates into roughly £lm of profits on the bottom line.

European sales +87% in H1

When Warpaint listed in 2016, the intention was to implement a strategy of making W7 a global brand and in particular their great white hope was the US, which is the world's largest colour cosmetics market (6x bigger than the UK). Unfortunately, a weak US distribution partner (Warpaint subsequently bought its distributor) and then the emergence of Covid knocked the strategy off course; in truth, as Bazini says, it also took longer than expected to crack the US market and achieve the listings.

When the pandemic hit, given the realities of

In this issue

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• Next issue on Saturday xx November

working from home, physical distancing, and mask wearing, it became much less important to wear make-up and fragrance but by 2021, things were back to an even keel. Sales topped £50m for the first time and Warpaint reported a pretax profit of £6.9m.

The latest H1 shows this progress continuing with sales of £25.1m, up 37% year-on-year and up 30% on 2019, which was the last pre-pandemic year. Full year forecasts were upgraded in September and sales are expected to be c£61m, which should generate pretax profit in excess of £9m - setting an all time record.

Close out original business

Looking at the latest H1, sales in the US seem small and flat but Bazini says some large accounts were won at the end of H1 and much of the growth in that period was from listings with several chains in Continental Europe where sales grew a blistering 84% making this his biggest region at 48% of sales. He says that the US potential will shine through next year - so this is why brokers have also upgraded their outer year eps forecasts (see table).

Warpaint was co-founded by Bazini and Macleod in 1992. At this time it traded as Treasured Scents and operated solely in the close-out industry - buying and selling on the excess stock of premium brand cosmetics and fragrances to discounters and chemists. It would source these directly from the star names such as Revlon, Max Factor and Calvin Klein and then sell them to high street outlets, wholesalers and the discount mass market retailers in the UK. The "close out" market is for branded articles supplied by sources, such as duty free shops, who have over-ordered.

That business was fine up to a point but there wasn't always the stock available and following a change in EU parallel import law in November 2001, further limiting opportunities within the close-out business, a year later Bazini, Macleod [xx] and a whole host of other talented people created the own-brand, W7, to allow them to supplement any shortfalls in close-out products when making a shipment to a customer. They then quickly built a complete range of cosmetics across all colourways and formats.

Five owned brands

After a slow start, the W7 brand took off during 2011/12 and enjoyed remarkable growth through to 2018. These days it comprises 500+ items, which are sold across the UK, Europe, Australia, New Zealand and the US.

W7 is all about colour cosmetics at affordable prices with eye-catching designs, mainly aimed at 16-30 year olds and distributed through chemists and independents. These days its biggest product lines are eye products (eye shadows, eyeliners, eyebrow pencils, mascara) and face makeup (foundation, blushers, illuminators, face bronzing lotions, creams). The smaller product lines comprise lip products (lipstick and glosses, lip pencils, lip plumpers), nail products (nail varnishes and polishes) and colour cosmetics sets/kits.

A further transforming development came in 2017 in the form of the group's landmark acquisition of Retra for £21.2m and its range now includes a full offering of colour cosmetics, gifting, skincare and accessories. Retra is more heavily focused on gifting products/sets than W7 and sells mainly to high street retailers and supermarkets including Boots, Superdrug and Asda. It added three own brands: *Technic*, *Body Collection* (premium packaging skincare for older skin) and *Man's Stuff*. To this Warpaint has added a fifth brand, *Chit Chat*, which is makeup for pre-teens.

Owned brands are expected to represent 90% of total group sales this year. Close-out will be the other 10% and whilst the latter is not a strategic focus, this side of the business has decent enough gross margins and provides a useful source of knowledge of the colour cosmetics market and access to new market trends. Of course, now we have left the EU, Treasured Scents is free to import excess stock from America and sell it in the UK cheaply without the brand owner's permission and I get the feeling that there could be some real opportunities coming the group's way, especially when it seems so many mid market cosmetic brands have been under the cosh recently - for instance, look at The Hut Group, Revlon and Revolution Beauty.

Outsourced manufacturing

Products for all of Warpaint's brands have historically been manufactured on behalf of Warpaint by carefully selected, certified manufacturers in China, which also manufacture for other leading global cosmetic brands. Warpaint pays these manufacturing partners in US dollars, and although there is an increasing proportion of US sales, which provide a natural hedge, it has been exposed to the foreign exchange movements.

The obvious vexed question is what happens now that the pound has plunged. To mitigate the impact, management point to the foreign exchange options to sell forward its expected Euro income in the year and in January, Warpaint also increased their selling prices. Additionally, Warpaint has begun to source some key product lines from European suppliers to ensure its sales margin is protected whilst maintaining quality and at the same time improving margin. This helped gross margins rise by 4.5% to 39% in H1, although Rodol says it will probably flatten out towards 35% for the full year given H2 includes more gifting items, which are lower margin.

Budget brands

One other perceived key risk is the reliance on the co-founders; they make no secret of the fact that the team is small but this gives them short reporting lines and an ability to make decisions quickly. COVID-19 has driven several trends in the beauty market in the last two years and Warpaint has been able to react quickly.

When it floated, it didn't even have a full time finance director, stock controller or account administrator for overseas sales; everything was managed by the co-founders. Obviously that has changed but headcount is only 110 and I get the feeling that the duo, now in their late fifties, still run this as the Bazini and Macleod show, with the founders holding 25.3% of the shares each. Schroders has 17%. All this makes for a tight market.

Since Covid, the beauty market has seen a huge channel shift with the number of department stores across the UK having dwindled; almost half of all department stores across England have closed during the past seven years - and those goddesses in white in the beauty halls from where you might once have shopped have gone with beauty e-commerce, powerful influencers and supermarkets/discounters taking up the slack.

A plethora of make-up upstarts also emerged, which quickly rose and fell on waves of social media interest. Some ended up being bought by the giants and others crashed to earth; for instance, Bazini says Revolution was essentially buying turnover with high marketing spend but remained lossmaking. Warpaint, on the other hand, has remained profitable, even during Covid and although it initially cancelled its dividend, it then later paid a special dividend.

As Bazini also adds, fancy bottles, seductive names and the fees of creatives who design them, add up. Buy an expensive cosmetic and you usually also get four layers of packaging - there's cellophane wrapping, then there's the box itself, then inside are layers of outer cardboard and then you get the actual bottle. Packaging can easily amount to three times the cost of the ingredients that make up the cosmetics. The premium brand companies are also spending millions on marketing and they are still managing to maintain massive gross margins of 300-400%. Instead, Warpaint has a no-nonsense affordable pricing policy with cheaper packaging but spends relatively little on marketing and by comparison it has a gross margin of c.35%. What plays nicely into its strengths is that its brands target the value end of the market with key customers being supermarkets and discount specialists like B&M, Wilko and Tesco - not just in the UK but overseas also.

Store based progress in the US

Within the Warpaint H1 numbers, performance was strong across the board, with Continental Europe (+84% at £12.1m) particularly eye catching and it is now 48% of the bigger total sales with notable growth in Denmark, Spain and Sweden. Looking at the core UK market, where W7 started, sales were up 17% to £10.4m driven by Retra. The UK continues to pick up speed helped by growing doors at Boots, which was only picked up in the last couple of years.

The US was flat at US$1.7m but looks set for good growth in H2 and beyond. In 2020 the division was restructured and the SKUs reduced to 100 best selling core items so that the 2,000 pallets kept in a third party warehouse could come down to 500 pallets and push the region to profits. Post the period end it secured accounts to launch 96 W7 products in 280 HBB, a large Texan grocer; and also 60 W7 products in 190 CVS stores. Bazini says the US is at the same exciting stage W7 was in the UK in 2011 before sales took off. Given the strong growth in the number of customers, Warpaint has invested to ensure it can meet customer delivery expectations and overall group H1 inventories were £5.2m higher to leave net cash of £4.3m.

Online growing from a small base

Good growth is also coming from Warpaint's online presence, which started in the UK in 2016 with direct-to-consumer e-commerce, such as brands' websites, shoppable social-media platforms, and marketplaces taking centre stage. Overseas, Warpaint has also launched bespoke B2C Chinese and European e-commerce websites but the preferred routes are Amazon, Tmall and Xiaohongshu sales platforms. Online sales were up 44% to £0.63m in H1 and should top £2m this year.

Overall, the channel may have shifted substantially during Covid and household budgets are squeezed but even in recessionary times, shoppers still tend to go for that pick-me-up. The so-called "lipstick effect" certainly looks set to buoy beauty's fortunes this year with industry data showing beauty sales are on track to record 8% annual growth in 2022 to reach £22.7bn, surpassing 2019's pre-pandemic levels. *I am a buyer.*

UPDATES

Kape (KAPE) **xxp**

Sector: AIM, Software & Computer Services

Kape has been dramatically sold off from the 440p high in March despite not putting a foot wrong. Including a maiden contribution from ExpressVPN, which was bought last December, sales for H1 to 30 June were up 217% to US$302m (+19% organic), pretax profit was +362% to US$46.2m and eps +279% to 34.1 cents. Adjusted EBITDA increased 210% to US$88.9m.

Kape's performance was driven by growth in the user base while retaining 82% retention rates, with user numbers hitting 7m, up from 6.6m six months earlier. Adjusted EBITDA margin was 29.4%.

The Digital Privacy segment (6.1m subscribers) experienced continued growth with sales up four-fold to US$253.5m at a gross margin of 51%. Chief executive Ido Erlichman says that post acquisition, by September it had successfully integrated the customer support and R&D functions. This will realise US$9m in synergies (four months in 2022) and US$30m on a full year basis. From the product pipeline new products are being developed and added to the SaaS platform, with increased functionality helping to keep the average cost at US$99, almost double the price of rivals and retention rates are high.

The other two sides also performed well. Digital Security was up 16% to US$21.4m (37% margin). Meanwhile, Digital Content sales were +25% at US$27.5m (19% margin), which was depressed by investment in a move into new verticals eg. Website Planet, a website building service for which strategy will be unveiled at a future Capital Markets Day, says Erlichman.

The other big new news to accompany results is that Kape intends to pay the deferred US$345m consideration for the acquisition of ExpressVPN early. Early repayment basically results in replacing the short term deferred consideration with a long term debt and shaves perhaps US$30m off the consideration. Separately, Kape has raised £171m at 265p. Existing investor Unikmind subscribed to £94m worth of the available shares. *Buy.*

GB Group (GBG) **xxp**

Sector: Aim, S'ware & Computer Services

GB surged after confirming a potential takeover from US private equity firm GTCR, making it the latest British tech firm to fall into the sight line of a foreign buyer. *It looks a steal for the buyer after the pound plunged so won't be the last bidder; await developments.*

Alpha FX (AFX) **xxp**

Sector: AIM, Financial Services

Since March 2021, FY22 forecasts have been upgraded five times and by 36% prior to H1 results so there were no real surprises in the results when I spoke to chief executive Morgan Tillbrook. Revenue grew 35% to £46.1m including £1.4m of recharged interest. Pretax profit (after absorbing the cost of adding 74 new employees and further build out of its tech stack) was up 16% to £17.8m, for eps up 21% to 33.3p.

Underlying pretax margin came in at 39% reflecting investment in staff and technology. But a keynote is that deferred revenue from account fees are recognised over the next 12 months - add those back and the margin would have been closer to 45%.

FXRM grew sales 31% to £32.1m driven by a 22% jump in client numbers to 975 since December whilst revenue per client climbed by 7% to £33,100. Front office headcount grew, with 34 additions. Strong growth in London and Amsterdam has continued, Milan is profitable within just a few months and it will shortly open in Spain. Only Toronto is a bit behind the curve due to a shortage of senior managers.

The ABS side saw sales up 7% to £13.9m. There were 40 back-office staff added - it now has 115. The number of live accounts invoiced is up >75% to 3,061 since December. There is clearly a strong first mover advantage behind all this and its tech stack has been built for corporate customers rather than retail clients and business is well spread with Tillbrook saying, for instance, that ING has real estate funds, infrastructure funds, and debt funds that are all now using the service to manage their day-to-day FX needs.

The ABS side is made up of spot FX revenue and account management fees and Tillbrook says work is very 'sticky'. Spot fees improve the risk profile as there is less credit risk and no margin requirement when compared to forwards. Alpha recognises account fees over a 12 month period. Therefore, deferred revenue has increased to £4m vs £1.1m as of H1'21. Net cash for the group also climbed 10% to £97m.

With momentum going into H2 very strong, eps of 64p for the year is erring on the low side. Buy.

Alfa Financial (ALFA) **xxp**

Sector: Software & Computer Services

Since my short Buy note last month, Alfa has said it has improved contractual certainty with two clients as well as requests for additional people on other projects. August performance was very strong with chargeable days at a record level. Expectations for the year are now £2m higher than they were a month ago. *Keep on buy list.*

CentralNic (CNIC) **xxp**

Sector: AIM, Software & Computer Services

CentralNic has announced the acquisition of MA Aporia, a media and native advertising company that is an exclusive supplier to CentralNic, and secures direct access to high quality traffic to monetise. In FY21, Aporia had sales of US$35m, gross profit of US$3.5m and EBITDA of US$2m. CentralNic has paid US$11.2m cash upfront, which equates to an exit multiple of c5.6x with a further US$7.8m based on future profits between FY22–24. *Strong hold.*

Facilities by ADF (ADF) **xxp**

Sector: AIM, Industrial Transportation

ADF has released its H1 to 30 June with sales of £12.6m and a reduction in EBITDA to £2.6m, down from £3.8m, although last year's H1 comps saw a post-lockdown bounce and not the typical seasonal lull in Q1. H2 is more heavily weighted towards large productions and is fully booked, hence it supports the full-year expectations of record adj EBITDA levels in FY22.

Cash balance stands at £16m despite growth in the total number of vehicles at the end of H1 to 550. This is expected to reach 600 by the year end. Cenkos forecasts eps of 4.6p for the year, lifting to 5.9p next year, to drop the PE to xx. *Hold*.

Lords Group Trading (LORD) xxp

Sector: xx

H1 saw sales up 20% to £214m split 49% Merchanting and 51% Plumbing & Heating. Pretax profit was up 35% to £8.5m with EBITDA margin of 6.6% (vs 6.2%). The previously announced industry-wide boiler shortages resulted in a weak P&H performance and this caused LFL revenue to emerge 3.3% lower - so all the growth has come from the four acquisitions since IPO. Eps emerged at 3.9p.

The acquisitions boosted the Merchanting division, which increased sales by 73% to £105.9m (LFL +14.5%) and Lords is continuing to outperform peers and gain market share. As I previously described this is essentially achieved through range extension, new site openings and localised operational gearing. EBITDA was up from £5.3m to £7.7m but margins were down from 8.7% to 7.3% reflecting customer mix and a lag between raising prices and these taking effect.

The P&H side saw a 7% drop in sales to £108.3m (like-for-like down 12%) although EBITDA rose 10% to £6.5m. Q2 revenues bore the brunt of weaker boiler sales as a direct result of component supply issues although this was offset by growth in new products in the renewables space (such as heat pumps and controls) and management actions (including shifting sales mix towards higher margin energy efficiency product ranges), and consequently ebitda margin went from 5% to 6%.

With the largest of its acquisitions (AW Lumb and DH&P Plumbing) set to contribute fully to H2's numbers, Cenkos forecasts £16m pretax profit/eps 7.7p for the year lifting to £18.6m/8.6p next year. *Buy on dips*.

Xaar (XAR). xxp

Sector: Personal Care, Drug & Grocery Stores

Xaar's latest H1 shows sales up 39% to £36.6m (14% organic excluding its acquisitions of FFEI and Megnajet). Adjusted pretax profit was £1.4m, a turnaround from a £1.6m loss, for eps of 0.9p. Net cash was down from £17.1m to £12.7m.

After encountering weaker demand in H1 last year, the historical problem child, the Product Print Systems business (EPS), which produces a range of printers for inkjet and pad printing on odd shaped objects (eg. saw blades, golf balls) has had an astonishing comeback. The printer ranges have been simplified by newly installed management and margins improved. Following a +34% year-on-year increase in H2, latest H1 saw sales +51% to £9.2m.

However, it is the newer Xaar printhead bit that I'm interested in. This side grew 2% to £20.7m but much has been done over the past two years to improve this business. First there has been the purchase of FFEI (sales £6.1m), which has been a game changer as Xaar has now launched a print engine (Versatex) that has eased the logjam manufacturers face and accelerated time to market of digital industrial printers, especially in China, which is where all the major OEMS for ceramics are. More recently it has also acquired Megnajet, which makes ink supply systems - the rationale is to become a one stop shop, supplying all the parts needed to make a printer and begin supplying its own inks (bought in from ink manufacturers), and to one day become a razor-and-blades business.

Xaar is now rationalising its printhead cleanroom at Huntingdon to reduce space and increase efficiency in Q1. Ahead of closing this for two months it forward bought some inventory, and better overhead recovery helped the Printhead business unit's gross profit jump 41% from 35% (£8.5 million from £7.1 million) - these margins are now not far from the time when it was absolutely buzzing in China a few years ago when it cornered the market for printing on ceramic - this is despite China being 20% of divisional sales (40% was EMEA and 40% US and both lifted sales).

China has the big OEMS for ceramics and they have been disrupted by Covid once again (sales -22%) but it's been the same for everyone, says Mills and Xaar has not lost work to rivals. Meanwhile, Xaar's great white hope is new printheads for printing with high viscosity inks on textiles and paper, which is trundling towards a Q4 launch (see August 21 issue), a market not reliant on China. It typically takes two years for an OEM to adopt and launch products but three OEMS have already been given beta products to test and so the big surge in sales could come earlier than 2025, hence this year remains a bit of a stub year with forecast eps of 2.7p in 2023 climbing to 15.7p and then 30.1p. *Buy on a two/three year view.*

AB Dynamics (ABDP) xxp

Sector: xx

ABDP has had a strong finish to the year and ahead of reporting results on 23 November, it said it now expects to report sales for FY22 of £80m, up 22% year on year and adjusted operating profit is anticipated to be ahead of current market expectations.

Growth in H2 has been driven by track testing, which was also strong in H1. Lab testing and simulation sales were broadly flat at c. £16m, mainly due to the timing of revenue recognition on larger contracts

Net cash at the end of August was £28m and is now being put to good use with the acquisition of Norfolk-based Ansible Motion, a provider of advanced simulators to the global automotive market for an initial £19.2m (£16.2m cash and £3m in shares). Ansible's products are used for a wide range of applications including evaluation of ADAS, autonomy, vehicle dynamics, powertrain development and motorsport and are positioned at the higher spec end of the market versus rFpro, which had been acquired by ABDP in 2019.

In the year ended 31 March, Ansible is expected to have made a £2.2m operating profit on sales of £12m - or 9.3x and more than doubles the group's simulation sales. Liberum has upgraded eps to 40.9p for the year ended, with 51.7p this year. *Keep on buy list*.

Strix (KETL) xxp

Sector: AIM, Electronic & Electrical Equipment

As chief executive Mark Bartlett says, domestic appliance industry is typically impacted early and hard in economic downturns but sees volumes pick up quickly and mirroring the typical demand pattens seen during previous recessions, a recovery seems to be happening already at Strix.

Interims show sales down 7% year-on-year to £50.7m due to a decline in Kettle Controls revenue offset by growth in its Water and Appliance divisions. Overall pretax profit was down 12% to £11.6m. Gross profit declined 5% to £19.5m with Controls -10.6% to £15m. Impressively, overall gross margin increased by 1% to 38.4%.

On the Controls side the volume of kettles fell 15% for the industry and Strix outperformed the market with an 11.7% drop in sales to £34.8m. Bartlett highlights that Strix has strong control over variable costs on the Controls side - in response to volume decline, it put everything on automated lines and also pushed through two price rises. All this was reflected in the operating margin, which was 25.4%, flat year-on-year despite the sales decline.

Helped by FXbenefits, Controls' gross margins climbed almost 5% to 41% to and this high level is likely to be sustained helped by the fact that 77% of production lines are now automated, a second price rise came in May, and the softening trend for its raw materials. All this enhances the usual 40:60 H1:H2 weighting and Bartlett also adds that the major OEMs are reporting an uptick in orders, which will translate into volume increases from Q2 23 onwards.

Elsewhere, Appliances and Water grew gross profit by 20% and 14% to £1.9m and £2.6m, respectively. Bartlett adds that investors should expect to see strong growth in Water and Appliances in FY23, with new product launches in Q4 and as the Group expands the number of online platforms on which it sells its products. Group net debt was £61.3m after lifting its inventory by £3-4m as it expands these businesses.

Based on full year eps of 13.3p and a dividend of 8.6p, the PE is 10.6x xx and the shares yield 6.1%. *Things are obviously very geared to the bounce back in high margin Controls revenue. I am a buyer*

Playtech (PTEC) xxp

Sector: Tourism & Leisure

Playtech had been in bid discussions since mid-October 2021 when Aristocrat first made a 680p cash bid - and during this time the market was starved of updates. But now, finally, Playtech's H1 shows strong momentum with sales +73% to €792m and EBITDA +64% to €203.8m. The divisional breakdown is pretty intoxicating.

Within B2C, the main business is Snaitech, which has maintained its number one position by

Editorial shareholdings of companies covered in this issue: xx

brand across retail and online sports betting in Italy. In the half it grew sales 182% and adjusted EBITDA was €131.7m or +154%m, benefiting from retail reopening when gamblers made their way back to the shops. Its retail betting licences were extended until June 2024, at a cost of €23m, while its gaming machines rights were extended until June 2023, at no cost. The group has set a new medium term EBITDA target for Snaitech of €300-350m. An incredible trajectory.

B2B revenues rose by 17% to €312m, with EBITDA of €77.2m. Regulated markets drove B2B revenues +17%, with Americas +37% and Europe ex UK +39%. Unregulated ex Asia was flat whilst Asia was -26% but who cares about that when there is such huge traction in the US with licences in six states, including: Golden Nugget, WynnBet, Resorts and 888 are all to go live in coming months. The group now has over 300 brands on its SaaS offering having added 50 in the past 12 months.

With net debt falling and brokers suggesting that the B2C side is worth US$1.8bn, the B2B side is in for "free" including the material footprint in Latin America, especially in Mexico with Caliente and online business Caliplay - with a potential $720m value. *Buy.*

Concurrent xx (xx) xxp

Sector: xx

Concurrent manufactures single board computer products and plug-in-cards for the defence sector (76% of revenue) and c.90% of revenues are exported. With the pound plunging, this is the sort of thing that should be doing well as it makes its products even cheaper for overseas buyers. Speaking to the company this month, although it has been a supplier to the US Department of Defence and Homeland Secuity for most of its 37 years, it has for the first time appointed a US "Build to Print" subcontractor. As new chief executive Miles Adcock says, not only will this give it a "made in the USA" sticker but it will also allow it to win bigger contracts ("tens of millions' rather than US$2m average currently.) Adcock is moving the business out of its 1980s command and control type setup - and that is not being unkind - with a complete board refresh; 40 employees joined in the past year and 20 left and the sales team now has nine (six new hires). He says in time he plans to move it away from just single boards and into systems. The group also has huge capacity and could run 3x7 day shifts rather than one shift a day. R&D is also doubling to £4m from £2.2m this year.

So all very exciting for the future, although the latest H1 is backward looking having been overshadowed by semiconductor component shortages with bottlenecks limiting manufacturing output. Consequently, sales fell 20% to £7.4m with gross profit down 26% to £3.7m. Profit after tax was £0.6m for eps 0.75p. A £3m additional inventory build out has left net cash at £9.3m.

With record order intake, post the period end the order bank has risen to £24.2m, which supports the full year sales forecast of £16m and £22.1m next year. Corresponding profit/eps forecast is £0.1m/ eps of 0/1p [xx] and £2.7m/3.7p. *It looks exciting for the future; await newsflow.*

XLMedia (XLM) xxp

Sector: AIM, Media

XLM has just reported its H1 with sales +38% to US$44.5m and adjusted EBITDA up 60% to US$10.6m. I met with recently appointed CEO David King just after the results and it's been surprising to see the dip in the shares as King remains very bullish on prospects.

With the operational reset to sports betting completed, US Sports betting accounts for US$30.2m (68% of total) and European Sports for US$3.8m (8%). The now slimmed down core bits are the Gaming vertical in Europe (sales US$8.4m) and Personal Finance (USS$0.8m).

In the US, XLM is active in 16 states and in H1 it acquired 116,000 real money players for its clients, most of which was on a CPA basis. Of the US sports betting income, US$9.6m came from connecting advertisers to gamblers from its owned portfolio (eg, Sports Betting Dime, Saturday Down South and Elite Sports NY) whilst US$20.6m was driven by media agreements. The latter is typically a news publisher with a heavy sports presence and as King explains, gross margin is 50-60pc for a gambler acquired on an owned site and 40-50pc for one under a media agreement, due to payaways to the site owner. Blended margin was 47%.

Last year saw spikey demand as New York, Louisana and Ontario became regulated and gamblers onboarded and H2 will see Kansas; as each of these initial spikes settle down, we will start to see a trend in profits emerge, says King, who talks about the US sports betting market continuing to expand by 20pc a year. Meanwhile, the move from 3,500 sites to now just 20 will deliver US$4m savings (US$5-6m in a full year).

Cenkos forecasts US$69.5m sales and eps of 2.4 cents but given an H2 bias, King cedes this looks lowball. Next year's is US$72.4m and 3.9 cents. *It's a very strange time in the market but I am inclined to buy the shares/strong hold.*

Crestchic (LOAD) xxp

Sector: AIM, Industrial Engineering

Crestchic, the world's largest loadbank manufacturer for sale or rent [xx] has seen profitability explode in the past couple of months. This month's interims saw a second upgrade since I made the shares a main buy in xx, with Shore Capital lifting eps for this year and next by 25% to 24.6p and 27.4p, following the 40% upgrade in September.

H1 revenues rose 35% to £21.3m for the six months to end June, with a greater mix of Hire (+43% to £12.4m) versus Sale and operational gearing driving a 163% increase in pretax profits to £4m.

Executive chairman Peter Harris notes that these upgrades haven't been driven by the data centre side (Texas only opens in October) but by two very large contracts in the oil & gas sector. The elevated price of gas following the Ukraine war has driven needs not just for remote generators from the sector but loadbanks are also used for testing wind power turbines and so on. Looking ahead, huge productivity improvements following the Burton factory expansion will ensure a bumper H2, as will the fact that its contracts in dollars or Euros are seeing windfall cash generation and further 'beats' to forecasts. *Keep on buy list*.

LUCECO (LUCE)

Sector :	Electronic & Electrical Equip.	
Latest Price :	xxp	
High/Low :	404p - 75p	
Market Cap. :	£xxm	
Shares in issue:	161m	
end12/2021 EPS/PER	19.8p	xx
end12/2022 EPS/PER est	12.4p	xx
end12/2023 EPS/PER est	13.7p	xx
Contact	ir@luceco.com	
Registrars	08716 640 300	
CALENDAR		
Int/Fins/AGM	SEP/MAR/MAY	

I was recently interested to see building materials supplier Travis Perkins launch an RMI Index, which is a periodical survey on tradespeople and how busy they are. Reading the latest one, it seems to be a lagging indicator for the health of the building materials and merchants sector - contrary to the positive outlook in the report, share prices in the sector have endured an awful period with steep falls (eg. Travis, Grafton, Lords, Victoria Plumbing, CMO and the like). Luceco, the manufacturer of electrical accessories (power sockets, light switches, cables and extension leads) and LED lighting through UK trade and retailers, such as B&Q, Screwfix, Tesco and Argos, has similarly been affected.

Historically, the performance of the sector would lag housing transactions by a few months but the two became detached when Covid started and there was a substantial increase in the time spent gardening and on residential repair and maintenance (RMI) – people doing up their houses. Regular readers will recall how Luceco saw its sales take off and in 2021 it reported an all time record £37.4m pretax profit/eps of 20.2p. The shares were added to GP3 in January '19 at 53.75p and soared to 497p (GP3 took a part profit at xxp) but now that the shares are back at 95p, I think it's time to revisit.

Sequential momentum starts to improve

I have just come off my call with longstanding chief executive John Hornby. As he describes, once lockdowns eased, everyone found other things to do with their time, which reduced consumer demand. Then, the squeeze on consumers and the weakening macro-economic outlook, exacerbated by the conflict in Ukraine, led to Luceco's retailer and hybrid channels to become hesitant in their buying patterns.

Hornby says he first noticed customers were becoming cautious on their inventory in April; some customers had expected high demand to continue and had over-ordered whilst some wholesale customers had accelerated purchases ahead of price rises coming in Q2. This led to a deferral of orders and the latest H1 saw sales down by only £1.5m to £106.5m but this masked the fact that two brand new acquisitions were 15% of the revenue line; exclude them and H1 like-for-like sales were down 16%. With a high drop through margin and a lag in passing through cost inflation, pretax profit was £10.5m (-43% YoY) and eps were 5.8p (-41%).

Cost inflation starts to improve

There will probably be more swings of the pendulum but Hornby says things are getting better. Although there is still more stock to work its way out of the system next year, some customers are beginning to re-order. At the same time, the recent drops in the price of copper prices and freight weak (in $ terms at least) provides a helpful tailwind. Gross margin was 34% in H1 but in H2 it is expected to bounce back to the low 40%s.

Eps forecast of 12.4p with 14.5p [xx] next year

Broker Liberum forecasts £22.5m pretax profit for the year to end December for eps of 12.4p, lifting to £26.5m and 14.5p [xx]next year, on a prospective PE of xx dropping to a soon to be prospective PE of just xx next year.

What I like about the business is that first, Luceco's core brands have a long history in the UK electrical accessories market, with BG Electrical founded in 1941 and Masterplug in 1988. Ultimately the end users of its wiring accessories are the hundreds of thousands of electricians and brand loyalty is key; wiring accessories represent a small proportion of total build costs, whilst safety, and therefore quality, is of significant importance. Having to return to fix a cheap socket that has gone wrong is often a false economy and this gives established brands pricing power and protects against new entrants.

Luceco in its current incarnation as a portfolio of electrical accessories brands (excluding the LED division) was established in 2005 when these two brands were brought together by Hornby who formed the group through a management buyout.

As part of Hornby's strategy to leverage existing routes to market, the group organically entered the LED lighting market in 2013, enticed by its rapid growth and the attractive entry point created by the disruptive technology. By FY15 it had grown revenues in its LED lighting division to >£20m. This rapid success led to a strategic shift in the company's focus towards LED, and the group changed its name to Luceco in 2016 to reflect this development.

Luceco listed on the Full List in October a year later when it raised £26m for the company and £67m for selling shareholders including the VC backers EPIC and Hornby, who presently owns 22% and 18% of the shares, respectively.

Vertically integrated

What makes Luceco unique is the fact that it is one of very few vertically integrated UK players. When Hornby formed the group, everything used to be made in the UK. Initially, Hornby turned to using Chinese subcontractors to make the business price competitive but by 2009, Luceco had invested in its own factory (100% owned) at Jiaxing, about 100km from Shanghai and which has since been expanded twice and this covers 53,000 sq metres. These days, 60% of products sold by the group are internally manufactured.

In total, Luceco employs 1,850 staff at this facility where it can carry out a whole range of activities itself (plastic extrusion, metal stamping, electrical assembly etc), giving it competitive prices; better control of quality; an ethical supply chain; and greater flexibility to introduce new products. New product development is also undertaken in China but Luceco has customer support teams local to its customers (primarily in the UK, but growing into Europe).

Acquisitions rapidly assimilated

The LED build-out of its product range constrained Luceco's ability to convert profit to cash up until very recently but what has added a new dimension to the story is that it recently began to use its balance sheet strength to make acquisitions.

As I describe below, two acquisitions were completed last year. The first was the £17m acquisition of DW Windsor, which supplements the lighting side, whilst the second was of UK-based Sync EV for £10m, which moved it into the EV charger market. Sync was acquired post the year end and DW completed in Q4 but already Hornby says the businesses have been rapidly assimilated into the group. DW, for instance, is now making use of Chinese manufacture alongside that in the UK whilst both businesses are making better use of the 90-strong design team.

As presently constituted, latest H1 results saw profit split as follows:

- Wiring Accessories (£7.9m);
- LED (£1.2m);
- Portable Power (£2.4m).

The keynote to this split is that although Luceco is generally viewed as an LED lighting play, it is Wiring Accessories that generates more than 6x the profit and has margins 6-7x higher.

Wiring Accessories - strong locally

The Wiring Accessories division supplies products under the *BG* brand, such as switches, sockets, circuit protection devices and consumer units and accounts for close to 70% of group operating profit in the latest first half, when it achieved a 21% EBIT margin (off from the 28.3% in H1 last year) against the group average of 10.8%.

The BG brand commands a loyal following amongst professional electrical contractors and has limited volume cyclicality; around 50% of the business relates to new builds and the other 50% to RMI.

Wiring standards vary from country to country and because of this, products tend to be local, not global, with local standards and regulations. This limits global mass production and commoditisation and helps keeps margins high. Because of this phenomenon, a significant portion of the wiring accessories market has traditionally remained in the hands of large local manufacturers. For instance, BG has c.20% of the £380m market for switches and sockets in the UK but a small global market share.

BG has therefore sought new avenues of growth by introducing innovative new products such as a range of sockets that have integrated USB charging and through the addition of decorative effects, such as chrome and screwless sockets/switches, customers are happy to pay a premium price. In particular, in recent years it has benefited in particular from a very strong relationship with Screwfix (the hybrid trade/retail wholesaler of tools, plumbing, electrical, bathrooms and kitchens), where Hornby estimates BG's market share to be c.50% in the categories it operates in. Screwfix has itself gained significant share of its market in recent years.

Scope to grow materially in EV chargers

Hornby has constantly evaluated opportunities to leverage its manufacturing and introduce new categories to its well-established customer base to drive further growth. A few years ago BG expanded into fuse boards, for instance, and it has achieved a 10% market share pretty quickly (£200m market).

Hornby now expects a similarly strong performance from the new EV chargers following the purchase of Sync EV, with a highly competitive single-phase Mode 3 EV car charger launched under a joint *BG Sync EV* branding. This is already being made in house in China, which gives it a cost and product availability advantage in a rapidly growing market. Revenues from charger sales were £2m in H1 but are expected to exceed £7m for the full year at an operating margin well above the average.

Hornby says the team is in the process of designing a higher power, three-phase charger for use in large homes and commercial premises. Alongside that he also has plans to enter the fleet market and is investigating on-street charging options.

Luceco LED lighting

If anything, the move into EV chargers is reminiscent of how the Luceco brand was set up and led to the entry into a new category in LED lighting by leveraging its existing trade and retail channels. Back in 2013, LEDs were very new. Early adoption was held back by high costs for the LEDs and poor colour accuracy (LED light tended to lack warmth) but LED chip prices have tumbled, driving an explosion in volumes and LED now has a compelling product proposition of >50 core products across different price points including flood lights, residential lamps and commercial ceiling panels luminaires, with probably 500 SKUs including beam width, dimmability, colour and so on.

Alongside sales to retailers and hybrid channels, Luceco has established a division for LED lighting within building projects. A couple of years ago, Luceco acquired Kingfisher for £10m to add a professional range and the acquisition of DW Windsor adds a manufacturer of outdoor and street-lighting equipment primarily to a public sector customer base (as well as Urban Control, which provides network solutions for infrastructure assets; and Pulsar, a supplier of architectural floodlighting for landmark buildings).

In the latest H1, LED lighting achieved a £1.2m ebit on sales of £40.8m, a 2.9% margin. This included DW for four months. But as Hornby says, just prior to acquisition, DW had won a flurry of street light tenders from local authorities. It subsequently experienced a hiatus in work but as Luceco enters H2 the picture has brightened.

Portable Power

Last in the mix is Masterplug, an unassailable leader for "off the wall" portable power products such as extension leads and surge protection products. It addresses the UK retail market through channel partners such as B&Q, Tesco and Argos with a market share of c.40%. It's the only part to still use outsourced manufacturing (partner Cixi Hongyi) and the latest H1 saw sales of £24m at a respectable 8.2% margin.

Unlike BG, Masterplug has a broader geographic opportunity and it already produces versions of extension reels conforming to different European electrical standards. It is a big supplier to B&Q in the UK, which forms part of major pan-European group Kingfisher DIY and this has helped win work with other parts of Kingfisher such as Castorama and Brico in France, Spain, Poland and Romania.

Shares look oversold

A return to normalised levels of revenue from Wiring Accessories is underpinned by indications from Hornby that orders are now improving and will start coming through in Q2 FY23 [xx]. Brokers are only just tentatively factoring all this into FY23 operating margin increases with 12% forecast for the full year and 13% next year due to the bounce back in higher margin Wiring Accessories revenue. At the same time, EV charger sales are also rapidly rising and it has two LED lighting businesses, which have infrastructure as their main drivers *The shares are starting to look oversold. Hornby always times his trades well; watch for signs of director buying. Liberum sees scope for margins to be restored to over 15% and potential for the shares to almost double to its revised target of 153p. I am a buyer.*

<< Continued from page 8

stand. Revenue is generated from competition ticket receipts, while the principal constituent of cost of sales (CoS) are the cars given away (average £70k RRP). Players select the car they want to win with the price of the ticket varying accordingly, i.e. the chance to win an Aston Martin will cost more than a ticket to win a Mini and prices vary between £1 and £5. Ticket numbers are not finite; in any given week, there may be around 10,000-15,000 paying online and each week there is a guaranteed single winner, irrespective of how many players enter.

For each ticket bought, players play 'Spot the Ball' – a skill-based game. The player is presented with a photo taken during a football match, with the ball having been removed from the photo; he/she must judge where the the ball should be in the photo. BOTB employs experienced judges to make the same judgment; this is a controlled and monitored process, and occurs after each weekly competition closes. The player whose entry is closest to the judging panel's position wins.

Scale is what has given the business barriers to entry - the financial cost of giving a car away every week is a significant deterrent for any would be rival, as they would likely operate at a significant loss until they grew their customer base to the size necessary to turn a profit. Direct competition is minimal – my research throws up one well known company (Omaze), which gives you the chance to win a house and BOTB is the go-to one for cars. Scale has also allowed BOTB to reduce the length of its competitions (originally running for around two months, now weekly) and also reduced the price to play.

Marketing spend is a key variable that drives new players to the website with campaigns on Facebook, Instagram, Twitter and Youtube as well as TV and radio. During the pandemic when everyone was stranded at home, BOTB experienced a massive demand spike and it rapidly picked up lots of new customers. Seeing CPA (the marketing cost to acquire a new customer) and LTV metrics that went in its favour, BOTB reported record profits of £14.1m on £45m sales in 2021.

At that point the founders tried to dash for the exit: a proposed sale of the company was followed with a placing of 2.5m shares at a lofty £24, suckering Slater Investments into taking a 9% holding (it has paid a 50p special dividend since).

Now, just over a year later, Sagi is buying his 29.9% stake at just 400p, reducing founders William Hindmarch from 32% to 11.9% and Rupert Garton from 9% to 3.4%. In the process, GIL becomes a licencee for all territories outside the UK and the agreement will also allow it to promote the business in the UK model on a revenue share basis.

Post lockdown, BOTB is clearly seeing reduced customer engagement as everything normalises and the cost of living crisis bites. Finncap forecasts profits of £5.3m/eps of 53.9p for the current year to end April, with £6m/59.5p the following year. But this months developements could see it scale quickly. *A very good time to make an investment; speculative but nonetheless very interesting.*

UPDATES & IDEAS

• **Best of the Best** (BOTB;xxp), which operates 'Spot the Ball' - a skill-based game to win luxury cars - caught my eye during the month after Globe Invest (GI), the family vehicle of Teddy Sagi, bought a 29.9% stake from founding directors and entered into a collaboration agreement to provide operational expertise and also execute a global strategy.

For those not familiar with Sagi, he is, of course, the self made Israeli billionaire businessman. After an epiphany in jail for bribery, insider trading and manipulating bond prices, in 1999 Sagi founded **Playtech** (PTEC; xxp), the owner of the iGaming platform, just before turning 30. By pooling together hundreds of players in a central network and then providing casinos with real life croupiers, Sagi revolutionised everything - things went so well that in 2008, the company agreed to launch William Hill Online for a 29% stake in the business.

Playtech became a publicly-traded company on the London Stock Exchange in 2006 and along the way Sagi used it as a vehicle to acquire several e-marketing and digital advertising businesses before he sold out entirely in 2018; and along the way he has had other interesting investments in bingo, payment processing (Safecharge), internet security (**Kape**) and Camden Market. BOTB is therefore a tiny investment in the context of Sagi's personal wealth of c.£5bn but there are lots of skillsets that could be exploited.

BOTB was also set up in 1999, the same year as Playtech, and ran its first competition a year later at Heathrow Airport where it presented customers with the chance to win a car. BOTB subsequently made the competitions available at other airports and then shopping centres such as Westfield but these days competitions are carried out online, although a retail location may serve as a location for gathering registrations.

A benefit of shifting the business online is that it is no longer dependent on airport or retailers renewing contracts (back in 2011, BAA terminated several contracts inflicting a lot of pain), nor does it incur hefty retail rents and it requires less staff and as a result is more profitable. Online revenue is more predictable, is not reliant on customers entering a retail location in order to enter the competitions but customers can play at the touch of a button. And by regularly emailing customers, BOTB can increase customer engagement and lifetime value (LTV).

BOTB is a really simple business to under-

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THE GROWTH PORTFOLIO 3

PERFORMANCE TABLE		**Change on One Month**	**Since Start**
Growth Portfolio		-xx%	+xx%
FTSE-100	xx	-xx%	+xx%
FTSE-All Share	xx	-xx%	+xx%

There's an old Fleet Street saying, "When a dog bites a man, that is not news but when a man bites a dog, that is news." After three years of Boris, I thought I might be seeing less of the unusual and unexpected. But in a month when we saw a new King, PM and Chancellor, it wasn't to be. The Chancellor took action to reduce energy bills for businesses and consumers before unveiling corporate, payroll and income tax cuts, exceeding those implemented during the pandemic. It all seemed commendable but the seemingly open-ended borrowing plans created persistent sell pressure for equities, torpedoing the GBP (Great British Peso) until the Bank of England stepped in with a gilt purchase programme, all reminiscent of the banking crisis. They are now simultaneously carrying out QE whilst raising interest rates, which tightens the market. I think there will likely be some political U-turns on tax policy to get us out of this mess.

Against that backdrop, I have spent the month catching up with several manufacturers (inc Warpaint, Luceco and Strix), all of which buy in dollars. FX might be against them but all three told me inventory destocking is coming to an end and a cooling trend in freight and raw materials is a helpful tailwind. Warpaint is first out of the traps with its eps forecast increased by 8% in September due to its international sales mix.

THE GROWTH PORTFOLIO 1

Starting Capital (1/11/94):	£25,000
Termination Value (12/7/01):	£297,142
Portfolio gain:	+1088.57%
FTSE-100 gain in period:	+89.19%
FTSE-All Share gain:	+84.99%

THE GROWTH PORTFOLIO 2

Starting Capital (13/1/01):	£50,000
Termination Value (28/11/14):	£653,643
Portfolio gain:	+1207.29%
FTSE-100 gain in period:	+17.51%
FTSE-All Share gain:	+34.39%

		Shares Bought	Date Bought	Buying Price (p)	Total Cost (£)	Present Price (p)	Value Now (£)
1000		EMIS	1/10/15	1045	10495	1880	18800
1000	^*	Softcat	7/12/15	229.2	2337	1270	12700
10000	*	SDI Group	15/2/17	20.5	2095	164	16400
1000	*	Alpha FX	27/7/17	470	4745	1795	17950
5000	^*	Kape	9/4/18	93.5	4720	270	13500
1000	#*	Future	9/4/18	329.5	3340	1535	15350
15000	*	UP Global Sourcing	31/1/19	59.9	9075	117.5	17625
4500	*	Luceco	31/1/19	53.75	2476	78	3510
60000	•	XLMedia	8/7/19	43.7	26330	33	19800
2500	*	Ergomed	22/10/19	313	7870	1122	28050
10000		Volex	9/12/19	133	13345	262.5	26250
15000		CentralNIC	9/12/19	63	9495	116.5	17475
4000		Mpac	3/2/20	290	11645	275	11000
26069	•∞	Reach	3/2/20	98.8	26019	73	19030
8000		Superdry	22/9/20	146	11783	122	9760
3000		Victoria	13/11/20	450	13545	369	11070
25000		N Brown	22/1/21	61.85	15508	23	5750
7000		Supreme	5/3/21	189	13275	85	5950
16000	•	On the Beach	5/7/21	199	32065	121	19360
25000		Staffline	7/8/21	65.4	16395	40.5	10125
10000		T Clarke	6/9/21	147	14745	137	13700
18000		Boohoo	24/5/22	78	14085	44	7920
						Cash £	91890
						Total £	xx

Transactions take full account of dealing charges and bid offer spreads. Income from dividends is ignored. Current holdings in the portfolio are valued at mid prices and include all buying costs. Starting cap £100,000 (2 Jan '15). * Part profits taken • Averaged down. ^Adj for special divs. # Adj. for rights issue ∞ Adj. for bonus share issue

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