THE SMALL COMPANY

SHARE WATCH

July 2022

MARKET COMMENT

The first six months of 2022 were historical for investors in three different ways.

First, the Russian invasion of Ukraine feels more like the beginning of something than a one-off moment of lunacy by Putin. That means we, as investors, must expect increased problems with energy, persistent supply chains blockages and inflation higher for longer.

Second, the beginning of the year appears to have been a 40-year pivot. What had been going up for 40 years, world equity and bond markets, are now in the early stages of a multi-year reversal. If the US stock market peaked on 3rd January 2022, as our analysis suggests, it will be years before the S&P 500 climbs to a new peak. I hope the latter is wrong, but it does appear to be the most sensible working assumption for investors today. This means you (we) need to figure out a path through this period, where the US will not provide a positive underpin for global markets.

Lastly, the idea of a 40-year pivot, or turning point, equally applies to interest rates and central bank policy. In the week beginning 13 June the world of central banking turned on a sixpence. In particular the Federal Reserve shocked markets with a higher than expected rise in rates, by 0.75%.

It doesn't sound much, but in the prior decade the Fed had prided itself on managing expectations - now it was being overtaken by events which it neither anticipated, nor meaningfully understood.

Central banks, including the Bank Of England, now appear muddled, trying to reconcile contradictory policies (fight inflation or maintain growth?) in a world riddled with deep uncertainty, which is the worst possible environment for equity markets.

Midst the last months' US stock market falls, the most important takeaway was that there was no panic, just determined selling, day after day. This tells you where you are in the market downturn - nowhere near the bottom, because as the nadir for the market comes into view, panic will be all pervasive. Yet valuations are already mouth-wateringly cheap amongst UK small companies and takeovers are increasing so there will continue to be a great many opportunities for stock pickers.

CRESTCHIC (LOAD)

Sector :	AIM, Industrial Engineering	
Latest Price :	191.5p	
High/Low :	208p - 97.5p	
Market Cap. :	£53.6m	
Shares in issue:	28m	
end12/2021 EPS/PER	4.1p	46.7
end12/2022 EPS/PER est	14.3p	13.4
end12/2023 EPS/PER est	15.6p	12.3
Telephone	01283 531 645	
Registrars	/	
CALENDAR		
Int/Fins/AGM	SEP/APR/OCT	

It's been 16 years since I first wrote on Crestchic, which became the new name for Northbridge Industrial Services this month and although I haven't written much on the shares in the past seven years, I have been keeping a weather eye on them.

The problem in the past with this one has always been that there were widely deviating performances from the group's two component parts. Whilst the Crestchic bit, which mainly leases 'loadbanks' for testing standby generators, has recently recorded its highest pretax profit level since 2014, the shine has repeatedly been taken off this by the other side of the group, Tasman, which rents drilling tools for the oil & gas sectors and had absorbed investment but been bumping along the bottom for years. So, whilst the Crestchic cash machine kept pumping, much of the oomph went out of the growth of earnings per share.

Things were so bad that 2019 saw the group deliver its first adjusted pretax profit in five years. It was only small and 2020 wasn't much better. But now Tasman has been sold and 2021 results show the benefits coming through. In particular, Crestchic is increasingly hiring out its loadbanks to customers in the data centre market, which has already driven two eps forecast upgrades this year and with UK manufacturing being expanded and a new sales office opening in Texas this quarter to target the US DC market, I think this could be the start of an upgrade cycle.

Focus on ROI

Crestchic has clearly had an eventful 16 years

In this issue

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• Next issue on Saturday 13 August

since it listed on AIM as Northbridge, a cash shell created by Eric Hook, a former director of Andrews Sykes, with the objective of creating an industrial hire services business. A key element of Hook's strategy was to focus on niche, specialist hire offerings and not to offer generalist types of plant hire eg. scaffolding or construction equipment, which are commoditised and competitive.

Contemporaneous with the float it had acquired Crestchic, a business selling and renting loadbanks. Crestchic was a great business but under pressure from investors to do a further deal, the subsequent Tasman acquisition in 2010 proved to be a bum one. There was some overlap in extractive industry customers but the weak oil price led to low utilisation for its hire fleet and low returns on investment (RoI). It also had a very ugly joint venture in Malaysia. Peter Harris, chairman, who I spoke to last month, says when the oil price came off a cliff, it saw almost 70% of its revenues disappear. This made it too volatile a business to be owned by a small PLC and he is glad it has gone.

Loadbanks used across five key sectors

Hook retired last year and although there is no chief executive presently, Harris has assumed the executive responsibilities. Maybe it needed someone to look at everything with a fresh pair of eyes. In less than a year, Tasman has become ancient history. Tasman's Australia and New Zealand operations have already been sold as have the Far East assets and it is currently closing down its sites there. Plans for the last remaining Middle East operations will be finalised this summer.

There is a case for saying that Crestchic needed to dump Tasman sooner. A key measure employed by management in determining whether to invest is the RoI. Crestchic's RoI has been consistently at 20% in two of the last three years (it dipped to 15% during the pandemic) whereas Tasman was nowhere near that and already the sale has freed up £4m+ to date, which has been redirected at Crestchic.

Meanwhile, Crestchic has been making loadbanks at its Burton on Trent site since 1984 and has become the third largest manufacturer of loadbanks in the world, a market worth £330m, in which it enjoys a global market share of 9%. Numbers one and two in the overall market are ASCO (Schneider Group) with c.35% and Simplex with c.11% but whereas Crestchic is global, the other two focus just on the US.

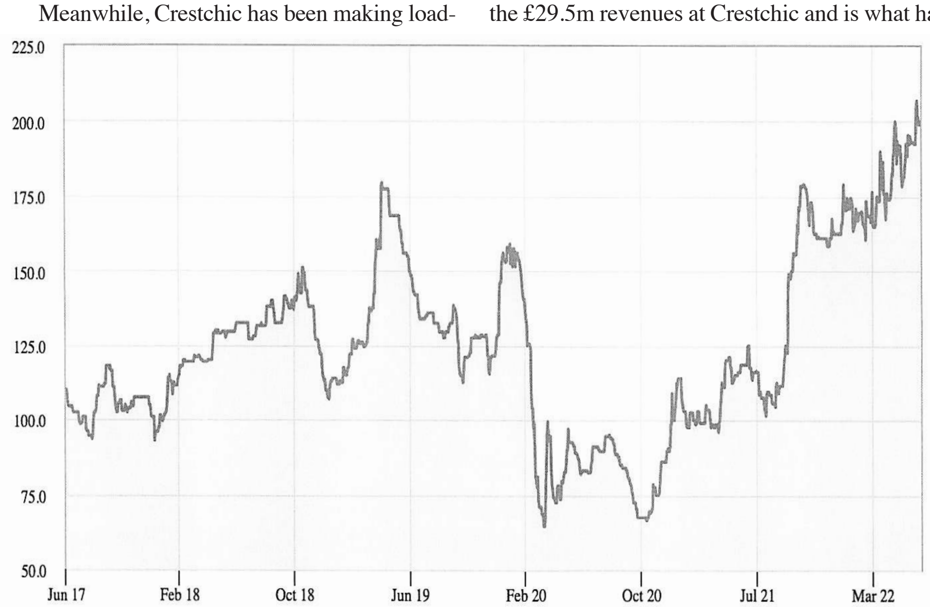
Loadbanks for testing standby power equipment

Loadbanks are traditionally used by engineers to test standby power equipment in critical infrastructure (eg. in the financial, communications and hospital sectors) during commissioning or for maintenance purposes by placing a load on the standby equipment that might be put into action in the event of mains failure.

A loadbank presents to the power source (such as the backup generators and uninterruptable power supplies) similar characteristics of a standard operating load, while dissipating the power that would normally be consumed by it and is converted to heat by a bank of resistive heating elements, which are cooled by fans.

Outside the built environment, large loadbanks are also used in extractive industries and in the marine sector. A mine, for instance, will often be operating totally off grid so the very large generators need to be tested before they are sent out to a remote location. In shipbuilding, many vessels built currently are all-electric for environmental reasons, with a single power network supplied by a primary engine source (banks of diesel generators or gas turbines). The power system enables a combination of propulsion, light, heat, air conditioning, refrigeration and weapons systems in military ships. A loadbank can simulate and test such systems, ensuring that the vessel is ready for launch.

All these are its traditional markets but what has created excitement for Harris is that in the last few years, Crestchic's range of loadbanks has expanded and are increasingly being used to commission and maintain the emergency power systems in data centre facilities. The data centre market is responsible for approximately 30% of the £29.5m revenues at Crestchic and is what has created a purple patch for the company.



Hyper-scale DCs are the "brains" of the internet. Their role is to process, store, and communicate the data behind the myriad information services we rely upon every day, whether it be streaming video, email, social media, banking or cloud services. Within these DCs there will literally be thousands of servers, storage drives and network devices and even a single data centre might use 150MW of power capacity, which is enough to power around 120,000 households so it is critical that the UPS and generators are periodically tested using a loadbank to ascertain that they will work when the need arises. Not only are the loadbanks that are used very big but often when a DC is being designed, loadbanks will be designed into the scheme rather than becoming an afterthought once the DC is up and running.

In addition, it is not just about DC power security. Because of the amount of equipment within a DC, they also have a lot of air conditioning equipment, which removes heat generated from the equipment and keeps the equipment at the right temperature and humidity and this also needs to be tested separately. By placing a smaller loadbank into a server room it will basically act as a large hairdryer and can allow the engineer to test the air conditioning against a stable and traceable heat source.

Expanding manufacturing to grow hire fleet

A loadbank that is used in a building may only be hired for a weekend whereas the larger ones can be hired for weeks and months. Some customers prefer to buy and so Crestchic sometimes sells a load bank to customers who want to own them outright; the smaller ones are generally more affordable at £1,000 whilst the larger ones can run to £150,000. They will have them permanently installed at a facility to be connected when needed. But for the large part, in future Harris says most of the manufactured kit ends up being added to its own in house rental fleet as it targets the US opportunity.

There isn't a great deal of technology behind a loadbank, which in the simplest form are steel containers containing hundreds of coils of copper, with the larger ones coming on a bespoke trailer. Equipment added to its own fleet is written down over a period of 10 years on a straight line basis but some equipment has been out in the field for 30 years and the fleet has a written down value of £6-7m but would probably cost £40m to replace. In terms of the current mix of the fleet, Harris says there are 75 large units and around 300 small ones.

Renewables a second driver

Whilst it's probably fair to say data centres are the big driver of loadbank demand, a second driver has fast emerged in the Renewables sector across Europe. In recent years energy transition has been a key driver of revenues, as new power sources are connected to existing grids. The power sources, such as wind, solar, hydro, battery storage and hydrogen, are inherently unreliable, requiring standby power generators to prevent power cuts. For instance, loadbanks are used for testing wind turbines before they are installed on the sea bed. By using a loadbank to simulate a load, an installer can test every part of the system, from the switchgear to voltage regulators, alternators to electrical cabling and fuel systems, ensuring that they will operate safely and reliably when powered up. Non-tested gas turbines can cause long delays for the customers and extra expense if they are damaged or fail to function.

Energy storage is also playing an increasingly significant role in ensuring the flexible operation of power systems. Crestchic already offers high voltage load tests at the grid/sub-station connection point to battery farms as they become increasingly integrated into the UK grid network.

An allied area is also the Electric Vehicles space; charging stations for EVs require testing post-installation.

Expands manufacturing by 60%

With demand running high and a record order book, Crestchic's site in Burton was bursting at the seams and a prime example of the RoI-led capital reallocation is Harris' commissioning of a new manufacturing facility adjacent to the existing site. The £2.2m cost, including fitting out, should experience a rapid payback, given a strong order book.

As Harris explains, lead times on customer orders increased to 26 weeks during the pandemic but even when the Covid-related restrictions lifted, lead times were still 22 weeks and this served to keep a lid on manufactured sales in each of the last three half years to <£7m.

The new unit will start shipping from mid-Q3 and expand manufactured sales capacity by 60% while lead times should be down to 12-16 weeks by the year end thus taking a 12 month sales potential from £14m to £22.4m. As well as delivering more sales it will also allow Crestchic to add to its hire fleet, with £2m investment in its rental fleet likely to achieve payback within 18 months.

Rental is higher margin

The latest results showed that Crestchic's revenues have already increased 20% to £29.5m, driven by a 34% increase in the higher-margin rental income to £15.5m. In other words it exceeded the previous record (FY19, pre-pandemic) by 8%. Revenue from manufactured sales improved 7% to £14m.

Clearly the key driver of Crestchic's business is rental of its specialist equipment, which has grown to £15.5m of the £29.5m turnover and it will be up to over £18m this year. As Harris says, Crestchic's gross margins on sales are 35-40% whereas that on rental are 75-80%. This means that from a shareholder's point of view, the most exciting thing that can happen to the business is strong growth in the quantum of rental.

The rising proportion of hire revenues was also the key driver behind the year-on-year increase in gross margins to 47.2% from 44.9%. The rising proportion of hire also offset supply-led inflationary pressures. The strong operational gearing fed through to an improved EBIT margin of 12.9% (FY20: 7.3%). EBIT increased 111% to £3.8m.

Filling in gaps on depot network

Very roughly, Europe, Asia and the US are the three largest regions accounting for a third of the £330m market. Reflecting this, Crestchic operates from 10 distribution hubs in Belgium, California, Pennsylvania, UAE and Singapore.

But there is clearly scope for it to start expanding its rental depots in existing geographies, as it begins growing its hire fleet. In particular, Crestchic is underweight in the US. It has a Pennsylvania hub but is restricted by time/transportation costs to other parts of the US and the forthcoming depot in Fort Worth, Texas opening this month addresses this (Austin is a digital hub in southern US).

Pays first dividend in seven years

The anticipated growth in such infrastructure is likely to be significant over the next decade. But even without that brokers have already started to upgrade. Earlier this month Shore Capital upgraded for the second time this year, lifting its FY22 and FY23 pretax profit forecasts by 16%/15% to £5.2m and £5.8m, respectively. Corresponding eps are 14.3p and 15.6p.

And the story gets better still with an expectation it will double its dividend this year to 2p. *I am a buyer.*

UPDATES

Hargreaves Services (HSP) 492p

Sector: AIM, Industrials

Having been upgraded just last month, Hargreaves has said FY22 ended on a high note with its German associate, HRMS, continuing to perform strongly. As I said last month, commodity prices, including zinc and pig iron, have maintained their high level since the Ukraine invasion and HRMS' contribution to Hargreaves results for the year ended May is now said to be £3.5m greater than had been expected last time. N+1 Singer has upgraded to £32.9m pretax profit/eps 97p with £25.3m/ 71.7p this year. Results are due on 27 July. *Keep buying*.

Photo-Me (PHTM) 76p

Sector: Leisure

As Covid related restrictions have continued to ease across its key operating markets, Photo-Me has seen stronger than expected trading. With five months still to go, it said that sales for the year to 31 October are now expected to show revenue up at least 24% and adjusted pretax profit in the range of £47-£50m. Net cash stands at £41.4m.

The Photobooths side saw a significant increase in its revenues, particularly in France and the UK, benefiting from pent up demand for passports. The division is now trading back at pre-pandemic levels across all markets bar Asia (which was only 7% of FY21 operating profit).

Outside photobooths, rollout continues of laundry machines. It installed 53 machines per month throughout the period representing 16% growth on the 4,094 in operation at October 2021. It also recently launched a new low cost laundry machine, Flex, and has already carried out several installations across Europe.

Combined, photobooths and laundry machines are well over 80% of overall profit and are the key swing factor, whilst coming up from a low base behind this is the food business, including the new pizza vending offer.

Finncap upgraded its current year forecast by 15% to £48.5m pretax profit and eps of 9.8p. Interims are due mid July. *Nice to see the January front page NAP surge to a new high of 82p in these otherwise difficult markets. Buy.*

EMIS (EMIS) Bid: 1925p

Sector: AIM, Software & Computer Services

EMIS has confirmed a recommended all cash offer at 1925p a share, which values the business at £1.24bn, a 49% premium. The bidder is Optum UK, part of US-based **UnitedHealth** (UNH.N), which said the deal would help the combined company to provide better services to the state-run National Health Service (NHS).

An excellent result in current markets showing the degree of undervaluation that exists. Originally tipped at just 373p in June 2010 and added to GP3 at 1045p, a second bidder may emerge as EMIS is a pretty unique asset. Await developments/possible counter bidder?

Fulham Shore (FUL) 11p

Sector: AIM, Travel

Ahead of reporting full year results on 21 July, Fulham said that trading has rebounded considerably. It opened 10 new restaurants in the year to end March and has an opening programme of 18 units this year. Of these, 11 are already in various states of undress (three opened and eight in fit out). New locations are also prime, "benefiting from historically low rental levels, the likes of which have not been seen for many years." Net cash stands at £3.6m with undrawn facilities of £15.9m,

Regarding current trading, whilst no financial metrics were reported, Fulham said March and April were in line: the progressive return of tourists is also helping the 17 units located in the West End and other city centres, albeit those in close proximity to offices have not fully recovered to pre-pandemic levels.

Due to its highly competitive price point, the company looks well set for more straitened times. It said that it has continued to manage all the industry-wide cost pressures through a combination of price increases, favourable rent review outcomes and strong top-line growth. But one keynote that few analysts seems to talk much about is the sector headwind that arises from the fact that VAT for hospitality stepped back up from 12.5% to 20% on 1 April having been cut during the pandemic and so prices have to rise in order to maintain like-for-like momentum.

Singer forecasts £3.6m pretax profit for this year underway with £6.7m next year, for eps of 0.4p and 0.8p, respectively. *Strong hold*.

Tortilla Mexican Grill (MEX) 129.5p

Sector: AIM, Travel & Leisure

I briefly touched on another value-for-money restaurant chain, Tortilla, in February's *SCSW*. This month the company acquired rival Chilango. The business was bought from RD Capital, which dubs itself as a "provider of permanent capital" but has flipped it to Tortilla for £2.75m, having bought it for £1m in 2020.

The deal brings in eight units, six of which are in London Zone 1 locations, which should benefit from the trend of returning commuters and tourists. Including new openings, it takes the total to 74, up from 64 at the start of the year and another seven openings are expected this year.

In Tortilla's hands Chilango benefits from more favourable buying power and also has access to Tortilla's 5,500sq ft central production kitchen to save costs. But interestingly Chilango now adds a premium flanking brand. While the menu is largely similar, Chilango has developed £5.45- £9.95 box meals covering a range of vegan and protein boxes, which have proved popular and in theory the brand could also leverage the same delivery channel - for instance, Tortilla could have dual representation on apps like Justeat and Deliveroo but have the food fulfilled from the local Tortilla unit or a dark store, without adding any additional costs.

Liberum says the acquisition is modestly eps enhancing this year but could add c.£1m to operating profit next year making it a bit of a steal. It has upgraded its forecasts by 3% to £3.9m pretax profit/eps 8.1p with next year's lifted by 30% to £4.3m/8p. The broker sets a 235p price target. *Strong hold*.

Calnex (CLX) 158.5p

Sector: AIM, Telecommunications Equipment

Lack of space meant I omitted my update last month. The latest FY21 results show another very strong year of trading, with sales of £22m, pretax profit up 64% to £6.0m and adjusted eps of 5.2p.

Net cash grew to £15.4m building on the money raised at IPO and post the period end it acquired iTrineg whose NE-ONE Network Emulation platform is used by customers who might be moving their applications and services into the Cloud to analyse and predict an application's performance by recreating real-world network test environments. It is a small deal at £2.5m - equivalent to 1.8x sales.

Meanwhile, demand for Calnex's own telecoms testing equipment remains strong. Overall, Calnex received orders from 233 customers in the year, up 34 and it said 91% of the total group revenues were generated from the sale of bundled hardware and software products, with 9% from extended warranty programmes and software support.

Its original customer base in the telecoms industry is in fine fettle using the system to test 5G networks for performance and conformance but new wins are coming from the hyperscalers all of which maintain huge datacentre capacity and networks, creating and managing vast quantities of data and Calnex's systems are used for the testing and performance monitoring of these networks.

Revenues from the Americas grew 23% to £7.1m, RoW +31% to £8.2m whilst Asia +15% to £6.8m (despite flat H1/22 partially due to ongoing geopolitical tensions between the US and China).

Cenkos forecasts £7.2m pretax profit/eps 6.3p this year, lifting to £7.7m/7p next year. *Tipped at 68p in December '20, new highs were seen last month. Hold for more*.

Supreme (SUP) 126p

Sector: Personal Care, Drug & Grocery Stores

Supreme has acquired Liberty Flights, a UK vaping manufacturer best known for their *Liberty Flights* vaping brand and the market-leading *Dot Pro* device. It has paid an initial £7.75m with a further £2m deferred for one year plus an earnout based on future performance.

Liberty Flights specialises in premium e-liquid and high-quality vaping devices, alongside distributing a large catalogue of global third-party e-liquid brands.

The brand is sold largely through convenience retailers, either directly or via wholesalers. In the year to end January 2021 the business had sales of £9m and EBITDA of £1.5m so is eps enhancing from day one - before further obvious synergies from purchasing benefits and manufacturing efficiencies. In particular it accelerates Supreme's product presence in the fast-growing pod system market - precisely the area the NHS will want for prescription products. Based on eps of 13p, the PE is 9.7. *I am due to speak to the company on 5 July. Buy.*

DiscoverIE (DSCV) 660p

Sector: Electronic & Electrical Equipment

The shares stand more than £3 below last year's 1028p placing, which raised £55m and allowed it to make two acquisitions that have 20%+ operating margins versus the previous group average of 7.7%. These were Beacon US, manufacturer / supplier of custom embedded computing boards predominantly for the medical sector and Antenova, a UK-based designer and manufacturer of antennas and radio frequency modules for industrial connectivity applications. It's the kind of high margin design and electronics manufacturing stuff that chief executive Nick Jefferies increasingly has sought - and February has also seen him complete his exit from the low margin business of electronic distribution with the sale of Acal BFi .

The two deals were included for six months in the full year results announced this month but have already electrified sales, profits, eps and margins. Sales were up 25% to £379.2m (organic +18%) with operating profit up 34% to £41.4m and eps up 61% to 26.3p. Operating margins have shot ahead by 3.2% since last year to 10.9%. Further organic improvements and annualisation of the two acquisitions will start to push the margin towards 13.5%, says Jefferies.

Continuing operations are now re-arranged into two new divisions: Magnetics & Controls (manufactures and supplies highly differentiated magnetic and power components, embedded computing and interface controls) and Sensing & Connectivity (highly differentiated sensing and connectivity components for industrial applications).

As Jefferies notes, 76% of the group's sales are from the renewable energy, medical, electrification of transportation, and industrial automation & connectivity sectors, which have long term structural growth. This is supported by a record orderbook of £224m, up 61%. The US$64,000 question, however, is whether customers who had been on heightened alert regarding supply chain issues have over-ordered and there could be an inventory correction but Jefferies says there are no signs of that although he is closely monitoring the rates at which customers sell through their own products.

Gross margins have been resilient with price increases offsetting inflationary pressures. As Jefferies says, his products are essential components, amounting to a small proportion of a customer's system cost. Organic growth during the year was strongest in Asia and North America (c.3ppts).

Net debt/EBITDA stands at 0.6x, which is well below the target of 1.5x and means Jefferies can still bring in other deals. Peel Hunt forecasts eps of 30.1p for this year - so a prospective PE of 21.9 but I think in better markets, the higher margins provide some scope for the rating to expand. *Buy*.

Bloomsbury Publishing (BMY) 394p

Sector: Media

Bloomsbury continues to shine. As the 25th *Harry Potter* anniversary draws near, it has just reported its best ever results with sales up 24% to £230.1m, with the three strategic acquisitions, ABC-CLIO, Red Globe Press list and Head of Zeus, contributing revenue of £17.4m (i.e. organic sales were +15%). Pretax profit was up 40% to £26.7m and eps of 25.94p were ahead of recently upgraded expectations. A net cash position of £41m helped underpin a full year dividend of 10.7p

The Consumer side grew its sales to £148m (+25% with LFL +18%) boosted by strong titles performance, especially Sarah J Mass; whilst Non-Consumer was £81.9m (+23% with LFL +10%) and saw the benefit of previous digital platform investment. Bloomsbury Digital Resources significantly outperformed management's previous targets and delivered £18.6m of revenue versus a target of £15m.

Consumer margin was 12% (vs 12.3%) as forecast with Non-Consumer at 11.1% (vs 8.3%) with Bloomsbury mitigating the pressures by printing physical books earlier to allow flexibility on where to print.

A new illustrated Harry Potter edition should support growth this year whilst on the Academic side it should benefit from the acquisition of ABC-CLIO. *Keep on buy list*.

Boohoo Group (BOO) 56p

Sector: AIM, General Retailers

Boohoo's Q1 23 was weak as had been anticipated last month, with sales down 8% to £445.7m. Making my job difficult is that these results, like everyone's, are being reported against comps that had been impacted by lockdown restrictions which limits the usefulness of assessing progress. I make four points.

First, all the feckless writers of headlines in the newspapers forget that Q1 last year had been influenced by lockdowns, which created a tough revenue comparator (Q1 last year +32%). By region, UK was strongest at broadly flat (-1%)

Editorial shareholdings of companies covered in this issue: Volex, Boohoo, EMIS, Photo-Me and Bloomsbury Publishing

whilst the US was weak (-26%) as it continues to be impacted by delivery delays. The surprise was RoW, which rose 15%, helped by wholesale growth.

Second, there was a drag from higher than usual levels of returns. Gross sales (before returns) painted a more positive picture, +9% overall and +21% in the UK, as customers continued to buy for events and holidays.

Thirdly, there was also an improving trend in gross margin, which was 52.8%, 2.2% lower year-on-year but up +2.4% on the low of 50.4% in H2.

Finally, looking forward, UK sales improved month-on-month during Q1 and May saw gross demand +21% heading into Q2. Boohoo expects sales to return to positive growth in Q2 for the group and it will benefit from less challenging comps (Q2 last year +19.3% growth).

So whilst there are all these clouds lingering, I am happy to stick my neck out and buy, but a little director buying wouldn't go amiss.

Kape (KAPE) 322p

Sector: AIM, Software & Computer Services

Kape's AGM reiterated that the integration of ExpressVPN, acquired in December, is well advanced and it has already begun to realise significant operational benefits to date, including cost-savings on back-office consolidation and leveraging economies of scale. Kape said it is well placed to deliver on its guidance of revenues of between US$610-US$624m and adjusted EBITDA of between US$166-172m (a 117% expected increase) for 2022. *Market conditions are pretty treacherous and I would have expected some give-back on its customer attrition rate but the statement suggests not so. Some profit should have been taken. Hold the rest.*

Frontier Developments (FDEV) 1372p

Sector: AIM, Leisure

The shares shot ahead after Frontier said H2 had gone with a bang and it would therefore report record full year revenues of £114m, 26% above the previous record of £90.7m achieved in FY21. Adjusted ebitda is expected to be £7-£8m down from £12m. It would have been even better but for there being an undershoot on *Elite Dangerous* and the officially licensed Formula 1 management simulation, *F1 Manager,* which is falling into FY23 (25 August launch and could be 30% of this year's sales).

The year, however, benefited from the major release of *Jurassic World Evolution 2*, which exceeded 1.3 million base game units sold and should benefit from a new movie. The latter has led to release of a movie tie-in expansion pack/paid-downloadable content (PDLC) including four new species of prehistoric animals and has had strong uptake. Alongside the internally developed titles, Frontier Foundry, its games label for publishing partner developments, had three new game releases including *Warhammer 40,000*, *Chaos Gate* and *Daemonhunters,* which exceeded expectations.

EBITDA is anticipated to be in line with expectations at approximately £7-8m versus £12m reported for FY21. The year-on-year reduction reflects greater investment in significant game developments for release in future years, including Formula 1 in August and its *Warhammer Age of Sigmar* real-time strategy game for FY24. However, due to the lower than expected engagement with Elite Dangerous: Odyssey on PC, the console launch has seen the game shelved and the results will also exclude £7m accelerated amortisation to write this down. FDEV's outlook points to continued medium-term revenue growth of c.20%. *Buy.*

Shoe Zone (SHOE) 180p

Sector: AIM, Retailers

A tiny update from Shoe but another monster 30% upgrade to forecasts. Pretax profit for the year to end October is now expected to be "no less than £8.5m," or 30% ahead of the £6.5m that was previously forecast driven by moderating freight costs, rental cost savings and selective price increases. Based on eps of 13.5p, that puts the shares on a PE of 13.3. *Tipped in March '21 at 67p and again in November at 101p, continue to hold.*

Lookers (LOOK) 75p

Sector: Retailers

Five months into the year and Lookers has said it expects full year profits to now beat expectations, in the light of which broker Zeus has increased its pretax profit forecast by 19% to £63m, albeit it expects a heavy H1-skew with £45m of the profit falling into H1. Overall, UK new car registrations were down 8.7% due to the ongoing supply shortages and Looker's new car sales tracked the market, whilst used car volumes declined 8.1%. Both have seen stronger gross margins. Aftersales revenues have been robust. The Group's focus on operational optimisation has generated cost savings that helped to offset material cost increases in other areas (e.g. staff and utilities).

The broker points out that based on eps of 12.9p, the PE is 5.7 and historically the sector trades through the cycle at 8-14x. The shares are also underpinned by cash and property worth 91p a share and Cinch, BCA and Webuyanycar owner Constellation Automotive has accumulated 20% of the shares. *A sitting duck to a predator; buy.*

We're updating our website

We're pleased to tell you that we've been working hard behind the scenes and will be launching our new website in coming weeks. We have improved the navigation, search function, mobile access and security for a better online experience with us. It's all part of our plan to add new functionality in future.

We are just in the final stages and hope to make a switch in August. The website address will remain the same but to access the new site on your first visit once live, you will need to reset your password. Subscribers who don't presently have online access will be able to request complementary access from the new site. We will provide an update next month.

RAMSDENS HOLDINGS (RFX)

Sector :	AIM, Financial Services	
Latest Price :	192.5p	
High/Low :	222.5p - 142.5p	
Market Cap. :	£61.6m	
Shares in issue:	32m	
end9/2021 EPS/PER	1.2p	160.4
end9/2022 EPS/PER est	17.3p	11.1
end9/2023 EPS/PER est	19.0p	10.1
Telephone	01642 579 957	
Registrars	01214 157 082	
CALENDAR		
Int/Fins/AGM	JUN/JAN/FEB	

Middlesborough-based Ramsdens' mainstay is pawnbroking - providing short-term loans to those without access to the mainstream lenders. It has most of its pawnbroking stores in the North and North-East and charges a fairly typical industry average of 5-9% simple interest a month on a piece of jewellery that is pledged for a small loan - at the average rate of 8.5%, that is an interest rate of 42% for five months.

With 156 stores, the business is just over half the size of rival H&T and although you might imagine that lending at that kind of interest rate is literally going to be a licence to print money, it's been a tough sector in recent years and has shrunk dramatically to perhaps under 800 shops. Many competitors had diversified into payday lending, where regulation hit hard, or had been too gold price dependent, and when their stores became loss-making they exited the market. But in Ramsdens' case it had luckily not had the payday lending issues but has instead focused on other areas to ensure that its stores maintain excellent returns.

Tailormade for current market environment

In terms of these other areas, chief executive Peter Kenyon points out that Ramsdens provides people with holiday money, which is suddenly doing well. As I describe below, Thomas Cook and Hays Travel pulled out of the market during the pandemic, allowing Ramsdens' FX margins to climb.

The FX activity has a spin off benefit of drawing customers into the stores, which helps boost sales of the jewellery Ramsdens retails in stores (this seems to be on fire with Kenyon saying that sales of watches were up over 176% in the latest H1 results). Alongside that it offers a gold buying service for those who wish to sell off unwanted jewellery and this too has been active with Ramsden's benefiting from the high gold price. Last but not least, even its original pawnbroking side has seen 20% more people in its stores as the cost-of-living crisis bites.

Scope for a "beat' on estimates

Just three months ago, brokers had been looking for Ramsdens to make anywhere between £3m and £9m pretax profit this year, but are now firmly forecasting £7m and there's plenty of scope for upgrades.

Ramsdens' first pawnbroking store opened in

Stockton back in 1987 (making it almost 90 years younger than H&T). Formerly known as Smith Cole Financial, the company acquired its first Ramsdens pawnbroking franchise in 1996.

Kenyon joined in 2001, by which time the business had three franchised stores and a year after he joined, it bought the master franchisor John Ramsdens Pawnbrokers, adding a further six owned and six franchised stores and adopting the Ramsdens name for the enlarged business. With the founding family continuing to hold a large stake, Ramsdens remained a family dominated operation but by 2009 the company had acquired 40 stores in Scotland and it then bought 20 in Wales.

In 2014 Kenyon led an MBO and since then the strategy has been consistent: to open more stores and to augment this by occasionally acquiring faltering stores from rivals (for instance, it has acquired two bundles of stores from The Money Shop since IPO) but the prime focus is about maximising the returns from the store network. Alongside greenfield openings, it currently has 156 stores.

Main customers are 'unbanked'

As Kenyon said to me, during the protracted lockdowns the narrative was that consumer balance sheets were strong; people weren't eating out, going to the pub or going on holiday and so were saving money, which limited demand for pawnbroking loans. In fact, during the lockdowns such lower levels of discretionary spending enabled consumers to accumulate over £200 billion in savings between March-20 to June-21. But that has quickly become ancient history and the savings rate has fallen. It seems that lenders are also really tightening up credit as the cost of living crisis is biting and this is bringing more people into its stores.

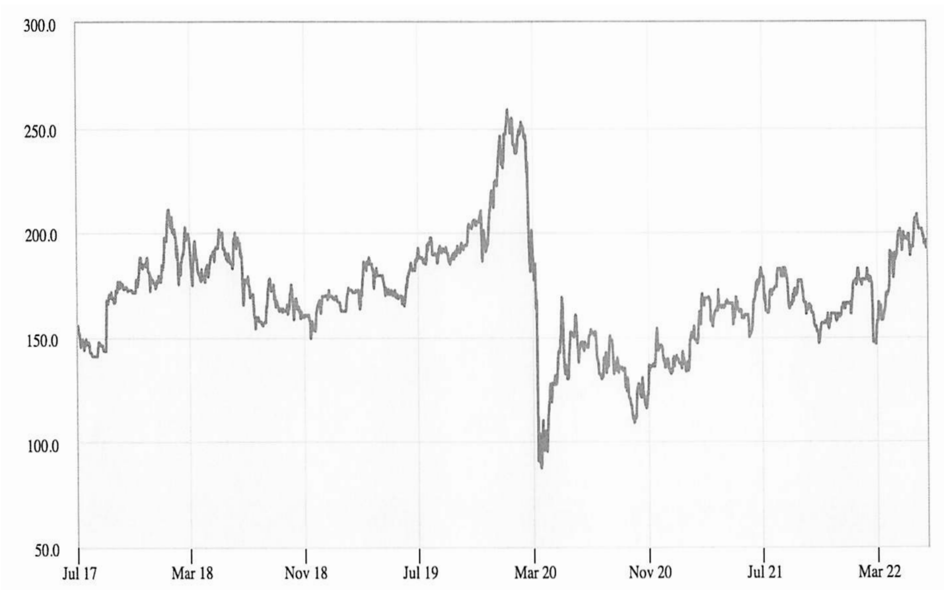
Last weekend's Mail on Sunday had an article about how one pawnbroker in the Capital called Sutton & Robertsons talks about a surge in demand being driven by middle-class customers and is reporting, "business is up by 25 or 30 per cent, thanks to an influx of working families with large energy bills to pay; previously comfortable households struggling to keep up with school fees; and small business owners in need of emergency cash." Many of their clients, they say, are seeking out pawnbrokers for the first time and are pledging their high end cars, jewellery and watches, which the pawnbroker will keep as security in case the customer is unable to pay the loan back. The typical loan amount is £5,000.

But that's not the norm for Ramsdens. Most of those who turn to it might be out of work or suddenly down on their luck and its average loan size is only £286. In the UK, there is a population of several million who, for various reasons, do not have bank accounts or who cannot approach a bank for suitable finance because they don't have a credit history. Pawnbroking offers them cash, simply and quickly, in the form of a short term loan.

Pawnbroking is an activity consolidated into the Consumer Credit Act and Ramsdens is fully authorised by the FCA for its pawnbroking and credit broking activities. The way Ramsdens works is to provide short-term loans to its customers for periods of between one and five months, with loans secured against gold rings and chains, gemstone rings and watches. The keynote here is that the loan is asset backed. Kenyon says that for 9 carat gold, which is worth around £18/gram, it will lend £12/g, against a retail price of £25/g. The loan to value is therefore around 65%, highlighting the secured nature of the business.

Customers are only required to provide ID and an address when pawning an item. They can buy back the goods at any time during the loan for the same amount that Ramsdens paid for it plus interest. Interest on a loan is "per month simple." For instance, one month and one day will represent two months.

Ramsdens' overall loan book has increased by £1.4m to £7.5m in the last 12 months. Earnings quality is high as each store has several hundred customers and even though an individual customer may have many items on pledge, any one only accounts for a tiny percentage of overall revenues. One of the drivers to the pawnbroking business is that 70% of all loans are ultimately redeemed: Ramsdens' supreme skill is to underprice the pledge to a level that ensures it is attractive enough for a customer to come back and redeem the loan. This ensures a good level of repeat business since the same item is likely to be pawned again in future.



Making its money from other areas

As I have already explained, Ramsdens lends between two-thirds and three-quarters of the valuer's estimate of the scrap value of the pledged item; ie. the aim is that the scrap profit is broadly equivalent to the interest payable on the unredeemed item.

At the end of a maximum five month loan period for a pawn loan, the small proportion of items that are not redeemed are sold through its retail unit or scrapped and the profit/loss is booked through pawnbroking interest.

When I began looking at Ramsdens, one revealing statistic was that its 'average' pawnbroking store has a pledge book of £46,000, which is very small compared to H&T and this reflects H&T's southern focus where there is a more dense population but it also suggests that Ramsdens is using its retail footprint to make its money in other ways. In fact, as the H1 results announced last month showed, pawnbroking represents only 23% of Ramsdens' £29.3m gross profit (down from 33% a year ago) whilst 20% is from precious metal purchasing, 31% is from retail jewellery sales and 22% is from foreign currency. The remaining 4% is financial services (cheque cashing and "sale-and-buy-back loans" against iPads and Xboxes), an area not targeted for the future.

Foreign exchange growing

In the short run, foreign currency exchange service is returning to be once more the fastest driver of growth.

Most of us still collect our holiday money face-to-face from the Post office, a travel agent or a store and Ramsdens entered the market in 2006 by undercutting the Post Office's commission.

The easing of travel restrictions in the UK and abroad has increased confidence and encouraged more people to travel. As a result, the demand for foreign currency has increased to approximately 60% of pre-pandemic levels with margins remaining higher than pre-pandemic levels as former rivals Thomas Cook and Hays Travel hit the rails and left the market. Kenyon says in recent weeks volumes have increased to c.85% of pre-pandemic levels. The reason this could have a double whammy on future profitability is that reduced competition has allowed it to increase its yield to 3.6% (FX revenue/gross profit is £94m/£3.4m), having been at 2%-2.1% for most of the pre-pandemic years.

Ramsdens hedges against adverse exchange rate movements for Euros and US Dollars by taking a monthly hedge for core currency levels held and a weekly hedge for intra month variable amounts.

Jewellery retailing taking off

Selling jewellery is a natural side effect of pawnbroking because it allows an alternative option for disposing of forfeited pledges over scrapping. Ramsdens' dedicated jewellery department will decide whether or not to scrap by selling to a bullion dealer who melts the items down (instant profit and a quick return of cash) or to retail the pieces (takes longer to turn back into cash, but generates more profit). More often than not it prefers the latter.

But these days unredeemed pledges are only a tiny part of the jewellery stock. Kenyon has increasingly been supplementing unredeemed pledges with specially bought in stock and it has the added benefit of making for attractive and modern window displays. He has also added watches and sales of these grew 176% year-on-year in H1 and is helping attract new customers to the group. Group net cash stands at £9.3m having invested £10m in additional jewellery stock in the past six months.

The product strategy is to focus on value for money, by selling at a discount to new jewellery. But although the jewellery it sells is relatively cheap, the company achieves a gross margin of over 38% on jewellery retailing. Jewellery retailing is going really well, with H1 gross profit up 55% year-on-year to £4.9m. Online jewellery retail sales also increased and now represent 15% of jewellery revenues. Kenyon says that the strong growth has been achieved through continued investment with particular emphasis on presentation of jewellery, an in-store layout and retraining staff.

Free gold option

The last bit of the mix is precious metal buying, which as Kenyon explains is mostly where Ramsdens buys unwanted jewellery, gold and other precious metals from customers for cash. Typically, a customer brings unwanted jewellery that's been lying unloved in their jewellery box into a Ramsdens store. A price is agreed with the customer depending upon the retail potential, weight or carat of the jewellery. The Group has second-hand dealer licences and other permissions and adheres to the approved "gold standard" for buying precious metals and like jewellery retailing, volume recovery is partially dependent on the footfall of FX customers.

Once jewellery has been bought from the customer, its jewellery department decides whether or not to retail the item or to smelt it into an ingot and sell it to a bullion dealer for its intrinsic value (with the proceeds then reflected in the accounts as precious metals buying income). The latest period saw divisional gross profit increase by 34% YoY to £3.1m and with the gold price expected to remain high due to the Ukraine/Russia war, Kenyon says it is likely to see more people selling their unwanted jewellery.

Forecasts upgraded

Ramsdens has opened three stores in H1 and is on track to open eight for the full year and Kenyon expects at least as many, if not more, next year. Although in the short run opening more stores might be expected to be a drag on earnings, the current mix of income seems to suggest that new stores will move to profitability very quickly. Consequently, broker Liberum expects £7m pretax profit/eps 17.3p this year rising to £8m/19p next year, to drop the PE to 10.1. *I am a buyer.*

<< Continued from page 8

Rothschild took the helm in 2014, it was a total mess with stagnating sales. As part of extensive restructuring he stripped out layers of management to reduce central costs, and unit costs were then lowered by improvements to its procurement and production processes through automation.

Sensible actions were taken to exit low margin business and move up the value chain with a succession of acquisitions to establish an integrated manufacturing service business, which offers sub contract manufacture of printed circuit boards, box builds and subassemblies. As more complex products, these are higher margin than a basic power cord. Rothschild's central proposition to customers now centres around superior service, be that quality, safety, global footprint or scale.

The acquisitions of the past mean that alongside the original power cord side, Volex is now positioned in four new and high growth end markets: complex assemblies for medical devices; high-specification copper cables, which are driven by growth in cloud computing/data centers; charging cables for electric vehicles (EVs) and defence. Together these are around 60% of group sales.

FY22 results this month show group sales up 39% year-on-year to US$615m with organic growth of 19%, which is pretty spectacular. Pretax profit was up 24% to US$51.4m, which was also above guidance. Operating margin shaded to 9.1% from 9.7% mainly due to a mix change of more power cords and less medical in the year but compares to margins of 1% back in 2014. Eps were 25.2 cents. After a six year hiatus up until 2020 when the dividend was reinstated, the dividend too climbed again by 9% to 3.6p.

By end market, organic growth in EV sales was 96%, Consumer Electricals 14%, Medical 13% and Complex Industrial Technology 6%. Clearly Volex proved adept at managing end-market growth and supply chain problems, in part by lifting the amount of inventory it holds. As Boaden says, a manufacturing process might require 50 components but if one is hard-to-find, you can't deliver your finished product. Volex has therefore protected its position by adding two weeks additional inventory across the board (84 days vs 70). Consequently net debt is US$95.3m for a net debt to EBITDA ratio of 1.3x so plenty of headroom for more deals.

Power products into EVs have been especially buoyant. Until now it has been supplying AC home charging cords. Volex moved into the area in 2018 and now at 17% of sales, Volex has become sector leader and is a sole-source supplier for Tesla but has also won significant business with others including Volkswagen and Ford. The EV market is still small (95% of vehicles purchased are still petrol or diesel) but as regulators increasingly focus on the reduction of emissions, EVs are set to be 40% of new car sales by 2030 - so will ensure growth for years to come.

Boaden says that last year saw the start of investment in EV power products to become vertically integrated - it now makes its cable for EV products in-house and this year will also start producing its own handles/charging gun - which helps control quality and enables Volex to keep more of the margin itself. It will also make it unassailable in terms of cost versus would-be-rivals. At the same time it has laterally expanded into DC chargers for faster charging and for on-street charging.

Another swing factor is Medical, which is 21% of sales and trading back at pre-pandemic levels. Volex supplies medical OEMs with electromagnetic interference protection, power supplies and complex sub assemblies into X-ray, CT, MRI and mammography equipment. Increasingly Volex is supplying a full sub system and these are high margin. Safety certification measures build long-lasting customer relationships and now hospitals are back to operating as normal, sales should accelerate.

Similarly the growth lights are also back on in the Complex Industrial Technology side where what Volex makes is again complex and highly specialised - with commensurately high margins. The division, which is 19% of sales, supplies defence, industrial and data centre customers. If you take out the data centre element from divisional sales, the other areas grew 12% last year, rather than the 6% reported.

As Rothschild says, Volex has invested to prepare for the next change in data technology. The growth of large web-service providers like Google, Amazon and Microsoft has driven a need for higher speed to handle higher data volumes. The 100Gbps and 200Gbps cabling is end-of-life and a switch to 400Gbps has begun with Volex's new cabling gaining a first-mover advantage. There was a lack of availability of wider DC products such as servers due to chip shortages but supply has improved and these all need the faster 400Gbps cables so it is on a roll.

Last year, Rothschild also moved into defence, another sector with mid teen margins. First he swooped on Irvine for US$16.4m, which provides turnkey assembly of printed circuit boards for Boeing and UTC. This was followed by Terminal & Cable TC, which supplies wire harnesses to the same defence customers. As Rothschild adds, rather than masses of wires, by binding the many wires and cables into a cable harness, they can be better secured against the adverse effects of vibrations, abrasions and moisture.

Last but not least, the Consumer Electricals (power cord) side is healthy and well. Its customers read like a Who's Who of household names with its cables going into TVs, game consoles, smartphones, laptops, fridges, vacuum cleaners, power tools, kitchen appliances, gaming machines etc. There could be slower volumes in recessionary times but FY23 will benefit from a full year of the Prodamex acquisition in Mexico, which supplies wiring harnesses for domestic appliances. Even before this deal, Volex was vertically integrated and had already begun to produce most of its own raw cable to significantly lower the cost of producing a power cord. As Rothschild says, Volex's global footprint is an advantage in a post pandemic world where companies want to near shore production and he highlights he has already successfully started to cross-sell DEKA's European customers into Volex's facility in Indonesia - with two key wins.

The year has started strongly with high customer demand and orders. The M&A pipeline is also tremendous. *Buy.*

UPDATES & IDEAS

• You won't need me to tell you this is a bear market. Even stocks reporting great results have continued to stagnate. Just take the example of **Volex** (VLX; 247.5p), which reported full year results that were slightly ahead of expectations. Based on a higher tax rate, eps estimates of 27 cents (22.1p) for the current year leaves the prospective PE ratio at a cheap looking 11, less than half of what it was last September.

I asked my colleague in the office which was worse, the Covid-inspired recession or now, when we have the more usual kind - an inflation and interest rates-driven recession. His comment was that Covid was worse because almost overnight companies were shuttered and had no sales. We got through that but now again we are in a market where most shares are in free fall. Volex went down to around £1 and then went back up to £5. Things again look oversold.

It's all rather strange to see Volex at this price because cyclical indicators, such as copper, are plummeting to new lows for the year as concerns grow over global economic growth. When copper was rising last year (as one of the input costs in power cords, cable assemblies, printed circuit boards and EV cables), the Cassandras had convinced themselves it was going to impact on Volex's margins and hit profitability.

During the month I briefly touched base with chairman Nat Rothschild and finance director Jon Boaden. As they point out, 2021 did not turn out to be Volex's 'annus horribilis' because it was able to pass on virtually all of the copper price rise to customers, albeit with a short lag, allowing it to report record results. The lag effect should now work powerfully in reverse with not just copper but other inputs such as PVC and freight prices also in decline.

The obvious counter argument is that demand will falter but there is certainly no sign of this with Volex planning to increase space at its locations over the next 18 months: Indonesia +52%, India +250%, Poland +75% and Mexico +22%.

This is all part of Rothschild's "bust a billion' plan to take sales to US$1.2 billion by the end of 2027 with an underlying operating profit margin in the range of 9-10%. If he achieves that, the present PE will be dropping towards 5, perhaps even less, as he has built very little operating leverage into forecasts. There is a sound reason for believing Rothschild can achieve his ambitious plan. First is the fact that he delivered on his first plan set in 2020 one year early.

Volex has been listed since 1939 and for the most part it was a supplier of power cords. When

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THE GROWTH PORTFOLIO 3

PERFORMANCE TABLE		**Change on One Month**	**Since Start**
Growth Portfolio		-8.49%	+331.97%
FTSE-100	7168.65	-4.84%	+9.48%
FTSE-All Share	3940.03	-5.38%	+11.80%

The old adage, "It's not about timing the market, but about time in the market," has been proven true over the years. With interest rates rising, corporation tax set to be hiked to 25%, inflation heading for 11% and a land war raging, a bloodbath has engulfed the markets but GP3 and its predecessors show the massive outperformance from our buy and hold strategy over 30 years (see tables). Once again I find that the downward lurches in share prices in small caps are really about (lack of) liquidity rather than any earnings underperformance against large caps. This has resulted in galling retraces since September but I was heartened to see the EMIS bid this month at 1925p, an 84% premium to the price paid. That together with the sale of Menzies means I will soon have a nice chunk of cash for additions and will be adding new holdings slowly in coming weeks.

The consequence of the market capitulation, says Peel Hunt, is that UK takeovers stepped up. In May there were 27 UK PLCs under offer versus the most recent high of 32 (August 21). If I had to name my top three small caps that could fall to bidders it would be Frontier (watch for 25 August F1 game launch), Alfa Financial Software and Lookers.

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	1860	18600
1000	^*	Softcat	7/12/15	229.2	2337	1299	12990
10000	*	SDI Group	15/2/17	20.5	2095	149	14900
1000	*	Alpha FX	27/7/17	470	4745	1530	15300
5000	^*	Kape	9/4/18	93.5	4720	322	16100
1000	#*	Future	9/4/18	329.5	3340	1688	16880
15000	*	UP Global Sourcing	31/1/19	59.9	9075	122.5	18375
4500	*	Luceco	31/1/19	53.75	2476	104	4680
60000	•	XLMedia	8/7/19	43.7	26330	29.75	17850
2500	*	Ergomed	22/10/19	313	7870	1020	25500
10000		Volex	9/12/19	133	13345	247.5	24750
15000		CentralNIC	9/12/19	63	9495	115.5	17325
4000		Mpac	3/2/20	290	11645	353	14120
26069	•∞	Reach	3/2/20	98.8	26019	101.5	26460
8000		Superdry	22/9/20	146	11783	134.5	10760
3000		Victoria	13/11/20	450	13545	448	13440
25000		N Brown	22/1/21	61.85	15508	22.8	5700
7000		Supreme	5/3/21	189	13275	126	8820
6000	•	Menzies (John)	7/6/21	308.5	18671	598	35880
6000		On the Beach	5/7/21	326	19703	140	8400
25000		Staffline	7/8/21	65.4	16395	46.75	11688
10000		T Clarke	6/9/21	147	14745	156	15600
18000		Boohoo	24/5/22	78	14085	56	10080
						Cash £	67772
						Total £	431970

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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