GROWTH COMPANY INVESTOR

Churchill's overseas success story ▶

Margins improve at **Volex** ▶

SRT buoyed by coast guard win ▶

Plenty of upside potential at **EKF** ▶

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The world according to GARP

Hunting for stocks offering growth at an increasingly reasonable price

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Market Outlook

April may have been an improvement on the preceeding month but markets still seem to be in limbo and patience is essential

Read more ▶

The GCI Portfolio

A flat month sees our portfolio lag the major indices as we struggle to find traction

Read more ▶

Best of the Blog

One of last month's New Recommendations has announced an acquistion that could prove transformative

Read more ▶

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Editor's Opinion

David Thornton

There has been a noticeable uptick in small cap bid activity in recent months. We made Hyve a new recommendation in January's *GCI* at 69p only for it to receive a bid two months later from a private equity firm. The offer at 108p is a 56% premium to our tip price and values the company at £315m. We liked Hyve as both a recovery play with its trade show market bouncing back from the pandemic and a restructuring story as its strategy shifted to major events in developed markets. So despite the healthy premium, we suspect there is a lot of value being left on the table with a consensus September 2025 p/e of 12x at the takeover price.

Another of our stocks to be bid for by private equity is Medica, which has attracted an agreed cash bid this week at a 32% premium. The 212p bid gives us a 69% gain on our December 2020 tip price. We have also had one of our tips recently acquired by a trade buyer (Crestchic/Aggreko 137% gain), while another is being taken private by its majority owner (Kape, 348% gain on original June 2017 tip, but a mere 14% uplift on last October's recommendation).

To state the obvious, takeovers are usually lucrative for shareholders. However there is also the sense that we do not always get full value (eg Medica is on a p/e of 14x 2025 forecasts) and it can be difficult finding a new home for the proceeds that is as attractive as the acquired business. Sure, there is instant gratification from receiving a bid; but we are playing a long game.

Why are we seeing this increase in takeovers? An obvious answer is valuation. Microcaps have been heavily derated across the board – growth stock premiums are diminished, and as we saw in last month's cover feature, there are many decent companies trading on single-digit p/e ratios.

Merger waves are usually associated with bull markets, but very low valuations, decent corporate balance sheets, and private equity houses with funds to deploy suggest takeovers will continue to be a feature. They should at least provide something of a backstop to small cap valuations and when we are tempted to sell a stock in this environment, it is worth considering what it might be worth to a potential acquirer. ■

● **Please note next month's *GCI* publishes on 2 June.**

The next issue of *Growth Company Investor* will be published on 2 June 2023.

GCI's Investment Policy

1. **Take a long-term view** – try to be patient and give your investments time to work out. *GCI*'s recommendations have a time horizon of 18 months. Remember that excessive trading incurs costs.

2. **Keep your portfolio fresh** – do invest for the long term, but do not be afraid to prune your holdings when necessary. Sell mistakes and stocks you no longer have confidence in. Better to take a loss and reinvest in a good stock than to soldier on with a bad investment.

3. **Diversify** – small-cap shares are riskier than blue-chips, so do not put all your eggs in one basket. Aim to hold at least a dozen stocks, but do not make the opposite mistake of holding too many (we think 20 to 30 shares are enough).

4. **Growth at a reasonable price** – this is what *GCI* looks for. The point of small-cap investment is to find growing companies. But we need to pay a reasonable, or better still a cheap, price for that growth.

5. **You have an advantage** – so use it! Professional fund managers have lots of constraints holding them back. *GCI* is here to help you exploit the freedom and clear personal objectives that you enjoy as an individual investor.

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New Recommendations

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Deleveraging will leave **NAHL** well placed to tap latent PI demand

Consumer legal services firm has clear strategy and value embedded in outstanding cases

The business

National Accident Helpline ads were once a familiar feature on TV. The company was a marketing and referral business, gathering personal injury (PI) claims and passing those which qualified on to its panel law firms for a fee. However, the sector underwent a prolonged period of uncertainty after the government announced its intention to introduce reforms aimed at reducing claim costs. This was particularly focused on notorious traffic accident whiplash claims, estimated to be costing the insurance industry £2bn per annum.

The reforms were finally implemented in 2021 after several years consultation. Injury tariffs were reduced and solicitors could not claim costs in most cases worth less than £5,000, forcing them into the small claims courts. This meant a large part of the PI market became uneconomic and many law firms exited the segment. NAHL's response was to set up its own 'National Accident Law' (NAL) firm to retain and process more valuable cases in-house. It also formed joint ventures with law firms to take a profit share of a referred case, rather than an up-front fee.

The downside in both these channels is working capital. A fee for referral generates cash in 30 days from a panel law firm, whereas a retained case incurs costs immediately with the payout taking up to three years to arrive. For example, the initial 2019 cohort of NAL cases saw 39% of its total expected value received in 2020, with 30% in 2021 and almost all the remaining 30% in the third year. As NAL has evolved it is retaining an increasing number of cases while offsetting the related working capital strain by continuing to refer an appropriate portion of leads to third-party firms for an up-front fee. The joint-venture channel is fading, since it makes sense to retain these cases in-house and get full value from them for a similar cash flow profile.

The market for PI claims has remained below pre-pandemic levels due to the government reforms and a related reduction in advertising by the industry. Management believes there is large latent demand and estimates the total PI market to be worth £1.1bn. It generated 35,000 enquiries last year, up 9%, with 51% of these non-traffic related (employers', public, and occupier liability), 22% were traffic accidents,

New Recommendations

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and 27% specialist. Its market share in non-traffic PI rose to 16.8% from 15.0%. A new TV ad campaign launched last summer which is a sign of confidence.

NAL has won 4,115 cases since its 2019 inception, generating £7m of cash so far. There are 10,860 ongoing claims with £11.2m estimated value attached to them. The company recognises revenue only when liability is admitted with a final adjustment when the case is settled; expenses are booked as incurred. There are no super-normal sized cases which could distort the picture and the book ought to be predictable. With the model starting to mature the PI business returned to profit last year and generated cash.

The company also owns a critical care business, Bush, which manages large £1m-plus catastrophic injury cases and provides expert witness services. Turnover last year was £13m (compared with £28m in PI legal services), generating £3.4m operating profit and £3.1m cash. It is a standalone business but has similar legal and insurer relationships as the PI side. Growth should be high single-digit as the company adds case managers and improves its use of technology.

Management and finances

James Saralis joined as CFO in 2018, becoming CEO in 2021. He is a chartered accountant and has an insurance industry background having previously worked for a unit of Marsh McLennan. CFO Chris Higham joined in 2016 and has held various finance function roles. There are three large institutional holders, Harwood 20%, Lombard Odier 18%, and Schroders 17%. With over half the equity in their hands and a shrunken market cap, liquidity is restricted and is something to bear in mind when considering an investment. The company has not issued shares since 2015 and the share price peaked that year at 420p, giving a market cap of £180m compared to today's £22m.

The investment case rests on successful deleveraging of the balance sheet as the caseload matures in NAL. Net debt at the end of 2022 was £13.3m, down from £15.5m the prior year. Forecasts have this reducing further to £10.3m this year, followed by £6.3m and £1.3m in December 2025. This reflects the maturation of existing cases becoming better balanced with the volume of new cases being taken on. The current bank facility has an interest rate of 2.25% over SONIA (currently *ca* 6.2%) and runs to the end of 2024. The leverage ratio of 2x net debt:ebitda is comfortable and is further supported by the embedded cash flow in the ongoing caseload which helps underpin the deleveraging thesis.

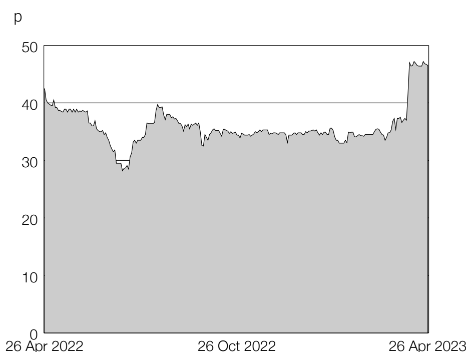
The company also owns a non-core property search business which made £0.3m operating profit on £4.3m revenue last year which will be sold when market conditions allow. As the cash position improves there will be scope to invest more into marketing and lead generation – and presumably reintroduce a dividend.

Valuation and outlook

Before our Teams call this month we had last spoken to NAHL back in 2018 when it was in the process of coming to terms with the PI reform proposals and was planning to set up what has become NAL. The shares were around 120p then, on their way to the 28p low reached last July. The shares then spent six months trading around 35p until the recent results which saw a jump to the current level. The strategy is very clear and the deleveraging is underpinned by the embedded value in outstanding cases. There is the risk that the rate of progress could be slower than forecast but the direction of travel seems assured. Going out to 2025 when new business will be balanced by the maturation of last year's case cohort, the stock is expected to trade on a p/e of 4.1 and ev/ebitda ratio of 2.3x. ■

NAHL GROUP ▶ READ MORE www.nahlgroupplc.co.uk

GCI Recommendation – **BUY**



Ticker: AIM: NAHL
Sector: Support Service
Mid-price: 46.7p
Spread: 46.4p-47.0p
12-month high/low: 244p/132p
Market cap: £22m

RESULTS	Turnover (£m)	Pre-tax profit (£m)	EPS (p)	DPS (p)	p/e	Yield (%)
Dec 2022 (A)	41.4	1.4	2.6	–	18.0	–
Dec 2023 (A)	44.5	1.6	2.7	–	17.3	–
Dec 2024 (E)	47.8	4.3	6.2	–	10.9	–
Dec 2025 (E)	49.9	7.3	11.3	–	4.1	–

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
Anexo Group	ANX	118.9	23.7	8.0
Frenkel Topping Group	FEN	86.6	2.4	19.3
Gateley (Holdings)	GTLY	219.4	18.0	15.2

New Recommendations

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Ever expanding government drives growth in opportunities for **PPHC**

Professional services company looks a promising play if it can address liquidity issues

The business

Public Policy Holding Company (PPHC) is a US-based professional services company which listed on AIM in December 2021 in a placing at 135p. The group was formed in 2014 through the combination of government lobbyist Crossroads and public affairs specialist Forbes Tate. Since then it has expanded by acquiring further firms in these complementary fields and adding senior hires. Such acquisitions supplement organic growth of 5-10%, which should be achieved through cross-selling more group services to existing clients and winning new ones. Operating under a corporate structure with substantial employee ownership, rather than as a partnership, the policy is to pay out around 70% of net profits as a dividend.

Lobbying in the US to influence government policy and regulatory agencies at the federal, state, and local levels is a big business. It is estimated to be worth $4bn at the federal level with a 4.1% pa growth rate over the last 25 years, while the state-regulated market is estimated to be worth $2bn. To UK ears lobbying can sound like a rather shady activity; but it is in fact highly regulated with the transparent registration of relationships mandated and spending being disclosed through the filing of semi-annual reports. There are civil and criminal penalties for non-compliance. Lobbyists are engaged by trade associations, interest groups, trade unions, and corporations to influence the votes of politicians and to shape legislation. Having access to and relationships with politicians and staffers is key.

Around 60% of PPHC's revenue comes from regulated lobbying with the remaining 40% from public affairs and strategic communications. This latter activity tends to take a longer-term more general approach to influencing public policy by focusing on journalists and other influencers to form public opinion. This is a more broadly-defined market and worth an estimated $11bn in the US.

So while PPHC might be a significant player, it has less than a 2% market share and the lobbying market remains highly fragmented. In 2022 the combined revenue of its Forbes Tate, Crossroads, and Alpine Group firms was

New Recommendations

$66m, making it the largest federal lobbyist with the next two firms earning $61m and $53m. In the words of CEO Stewart Hall, demand has grown with the "explosion in the size and scope of the government". Since 1990 US government spending has risen almost six-fold from $1.2tn to $6.5tn and regulatory reach has expanded with it. Unfortunately (or fortunately for PPHC) it shows no sign of abating!

PPHC's main revenue model is a retainer payment. The company has over 1,000 retained clients and very little work is billed on a time and materials basis. This should mean profitability is relatively predictable and the client base tends to be sticky with little churn. Other growth opportunities will come from an increasing demand to lobby and influence pan-national organisations such as the G7 and G20.

Europe is a growing market as illustrated by EU-wide rules like GDPR and it is reasonable to assume PPHC will aim to acquire a presence on this side of the Atlantic before long.

Management and finances

Several of the senior management worked for firms which were sold to WPP but then wanted to return to a more focused independent environment, rather than work for a communications conglomerate. However, that background has helped them appreciate the benefit of retaining separate brand identities and fostering entrepreneurial drive within a group holding structure. For firms joining PPHC there is the attraction of having the burden of admin and finance overhead passed to the centre and equity can be used to attract, retain and incentivise talent – there are around 140 equity and option holders out of a total of 340 employees. Another key benefit of the group structure is the ability to cross-refer clients, with a 10% referral fee offered to staff as an incentive.

CEO Stewart Hall worked as legislative director to a senator before co-founding a lobbying firm which was acquired by WPP in 2005. He subsequently left to establish Crossroads and co-found PPHC. He owns 5% of the company and the ownership of other management members and acquired firms means the free float is limited – liquidity is a problem and the board is aware of the need to improve this. Institutional owners include Chelverton and Miller Value Partners with 4% each.

There was $21m net cash at the year end which helped fund March's acquisition of MultiState for an initial $22m, with $4.4m of the consideration paid in stock. This deal brings strengths in research and compliance along with state-level advocacy and will be earnings enhancing. The aim is to maintain ebitda margins in a very healthy 25-30% range with 28.7% achieved last year. This level of profitability and the importance of dividends to the employee shareholders means we should have confidence in the yield.

Valuation and outlook

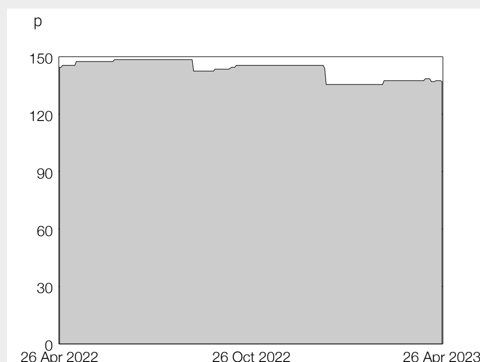
The shares are clearly very cheap. Three-year dividend growth is forecast at 10.5% pa on a starting yield of 8.2%. If the stock price were to double we would still be looking at a prospective (FY2024) p/e of 13.8x and 5.1% yield which looks perfectly reasonable, if not cheap, for a business with these margins and growth prospects.

The fly in the ointment is liquidity. The company claims the free float is 25% which in the context of a £154m market cap equates to £38m. However, the stock price has barely budged over the 16 months it has been listed and there have been several weeks without any trades being recorded. The best way of addressing this would be a placing to a wide range of investors to fund an acquisition, which is a possibility. If you can manage to buy the stock, you at least get paid handsomely while waiting for a rerating. ■

PUBLIC POLICY HOLDING COMPANY ▶ READ MORE

https://pphcompany.com

GCI Recommendation – **BUY**



Ticker: AIM: PPHC
Sector: Support Services
Mid-price: 137.5p

Spread: 135p-139p
12-month high/low: 135.5p/148.5p
Market cap: £154m

RESULTS	Turnover ($m)	Pre-tax profit ($m)	EPS (p)	DPS (p)	p/e	Yield (%)
Dec 2022 (A)	108.8	31.1	21.1	14.0	8.1	8.2
Dec 2023 (E)	138.8	36.1	23.2	16.2	7.4	9.4
Dec 2024 (E)	150.0	39.8	25.0	17.5	6.9	10.2
Dec 2025 (E)	161.3	42.8	27.0	18.9	6.4	11.0

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
Gateley (Holdings)	GTLY	219.4	18.0	15.2
WPP	WPP	10,284.1	1,159.8	13.2
M&C Saatchi	SAA	209.0	5.4	10.2

New Recommendations

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Improved client base and product mix puts **Argentex** back on the front foot

Foreign exchange services provider has strong momentum, with revenues up by a third

The business

Argentex has been a rather disappointing share since it came to AIM in June 2019. The IPO was done at 106p but the first day's closing price of 133p is 13% higher than the current price. The shares did hit 200p in early 2020, but the company then had a difficult trading period during covid-19 which, when combined with increased investment in the business, resulted in meaningful downgrades in 2021. However, the shares bottomed out last summer and there is a sense that the business is now more substantial and broadly based with extra avenues of growth open to it.

The company was founded in 2012 and provides foreign exchange services predominantly to corporate clients (private clients are only 2% of revenues). The target customer will have been using their clearing bank for FX and not receiving a very good service in terms of advice, execution and pricing. Very large corporates with sophisticated treasury functions can look after themselves, but mid-sized businesses with a requirement to hedge a few million or tens of million will gain by using a dedicated intermediary like Argentex. Last year the company traded on behalf of 1,595 clients, 409 of which were new. The biggest customer sector was financial services comprising 27% of the total, the next largest was construction at 9%, followed by a wide range of diverse industries. However there is still some customer concentration risk with the top 20 clients generating 39% of revenues.

The sales team is recruited on a 'grass roots' basis – coming to Argentex without prior FX experience and being trained to sell the 'Argentex way'. Sales was disrupted during covid-19 but new accounts accelerated last year, rising 17%. Repeat business has grown as a proportion of the whole as the business has got larger and accounted for 80% of last year's revenues with 20% coming from new customers. Sales is separate from dealing and a new client is provided with a dedicated dealer to help them quantify their risk and discuss the optimum strategy to deal with it. Clients use Argentex to hedge commercial FX risks and make payments through spot and forward trades, as well as higher-margin structured solutions which involve options

New Recommendations

and account for 10% of revenue. A higher-value product mix coupled with onboarding quality clients who trade more frequently resulted in a 45% increase in revenue per client last year.

The company has been investing in its systems with CEO Harry Adams describing the IT as "unrecognisable compared to 12 months ago" when we spoke recently. Clients can trade using the online platform as an alternative to speaking to their dealer and an Alternative Transaction Banking service has been launched offering virtual IBANs for multi-currency payments. The team has also been strengthened. People investment includes structured solutions specialists and an institutional team to focus on the financial services sector. The overseas investment in the Netherlands is also coming to fruition with revenue of £2m ahead of forecasts. This business has an EMI licence which can be passported across Europe where the market is felt to be 7-8 years behind the UK and offers a huge growth opportunity.

The impression is one of a company that is acquiring scale and has been making investments in product, IT, and international that are just beginning to pay off and have significant potential. Ebitda margins have fallen from the high 30s to their current 29-30% level reflecting this investment phase. The aim is to get back to the mid-30s which is reflected in the broker forecast for 2025 with an eye-catching 42% jump in earnings that year as operational gearing takes effect.

Management and finances

Adams co-founded the company with backing from Pacific Investments which retains a 13.6% stake and board representation. Adams holds 12% of the equity. His co-founder and co-CEO Carl Jani, who had a similar shareholding, left the company in 2021 and sold his stake that year. Former employee Andrew Egan owns 5%. Gresham House is the leading institutional holder with 10%, with Fidelity and AXA at 4%.

The company is changing its year end to December from March so we have just had a formal nine month report but the table shows annual data for 2022. Risk management is a core function of course and historically bad debts have been low – a problem would arise when there was a significant swing in exchange rates coupled with a client defaulting on margin payment or settlement. The company does not take principal positions and all trades are matched. Cash stood at £29m in December of which £12.8m was payable to clients and there was no bank debt.

Valuation and outlook

Having been through a difficult period we get the sense that Argentex is back on the front foot. The forecast revenue growth reflects the expansion and improving quality of the client base, combined with a higher-value product mix and the ramping up of the Amsterdam office. With margins expected to recover to the 35% mark from 30% there is premium growth in prospect which is not reflected in the modest valuation of the stock.

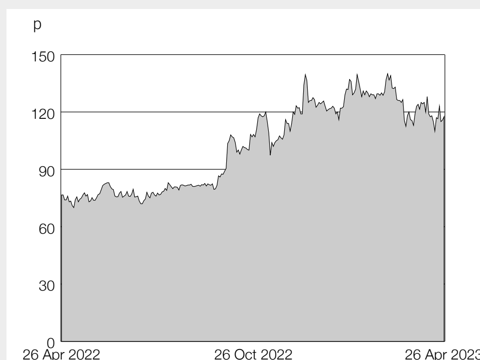
While FX peer Alpha Group (AIM: ALPH, formerly Alpha FX) is larger and has had a superior growth record, it trades on a p/e of 26.4x. Management struck a confident tone when we spoke after the numbers in early April and the RNS stated "the strong momentum" during 2022 has continued into the first quarter of 2023 with revenue up 34% on the comparable period.

The shares are consolidating a strong rise from the 80p level during the closing months of last year and have pulled back after reaching 140p in early March. This looks like a decent entry point to a classic 'GARP' (growth at a reasonable price) idea. ■

ARGENTEX GROUP ▶ READ MORE

www.argentex.com

GCI Recommendation – **BUY**



Ticker: AIM: AGFX
Sector: Financials
Mid-price: 117p
Spread: 115p-119p
12-month high/low: 140p/72p
Market cap: £131m

RESULTS	Sales (£m)	Pre-tax profit (£m)	EPS (p)	DPS (p)	p/e	Yield
Dec 2022 (A)	50.4	12.0	8.6	2.3	13.6	1.9
Dec 2023 (E)	60.0	13.4	9.1	3.0	12.8	2.6
Dec 2024 (E)	74.0	17.9	11.8	3.5	9.9	3.0
Dec 2025 (E)	86.4	25.3	16.8	4.0	7.0	3.4

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
Alpha Group International	ALPH	942.2	47.2	26.4

Recommendation Updates

CHURCHILL CHINA — HOLD

Date recom'd	Recom'd price	Price now	Gain
Oct '18	1,130p	1,640p	45%

There is plenty to like about Churchill. Meaningful family ownership results in management taking a long-term view over strategy. Most importantly, the company has a highly visible opportunity in export markets for its hospitality-focused products which should generate many years of healthy growth. Following our tip the shares rose to a high of £20 at the start of 2020 for a 77% gain in 18 months; but were inevitably hit hard by covid-19 given the pandemic's impact on the hospitality trade. Management's reaction to this shock was to furlough the majority of its workforce. However, while this was an understandable response at the time, it created problems that the company is still dealing with. Many highly-experienced workers failed to return and over 200 members of today's workforce have less than one year with the business. This means productivity has taken a hit and extra resources are being focused on training and staff retention. The 2019 year saw an operating margin of 16.6% on £67.5m sales, while last year the margin was 11.2% on sales which were 22% higher at £82.5m.

The good news is that demand has normalised and the company continues to take share in its overseas markets. Getting distribution right is key and takes time – for example, Europe has 430 distributors compared to just 40 10 years ago and now accounts for 38% of group sales. Europe grew 32% last year, yet market share is only 5% which illustrates the scale of the opportunity. However, the current year p/e of 22x looks full and evidence of margins recovering towards previous highs will be a key factor in delivering future outperformance. ■

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Churchill: gaining market share overseas

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Volex: reassuring margin improvement

VOLEX — BUY

Date recom'd	Recom'd price	Price now	Loss
Aug '22	283p	248p	12%

When we recommended Volex last August it had pulled back 43% from its 493p bull-market high at which point it sold on a p/e of 23x. Our view was that it looked to be forming a base between 240p and 280p and on a p/e of 12x should do well if the global economy achieved a soft landing. That 240p base held until this February's general weakness in small caps saw the stock trade close to 200p during March and early April, implying a p/e of just 7.5x for the year which ended in March. The valuation at the peak in 2021 was excessive, as was that of most popular growth stocks; however, that is a staggering derating given the absence of downgrades.

The company released its end-year trading update on 18 April which provided some relief. Revenue for the March 2023 year will be at least $710m which is a 15% increase and a little ahead of consensus. Similarly, operating profit grew 17% and the margin improved to 9.3% from 9.1% last year and 9.0% at the interim stage. The net debt performance was very good with a $22m reduction in the second half to $76m which represents a comfortable leverage ratio of 1.0x.

This is a very reassuring update which should support a modest upgrade. More importantly it suggests the business is being well managed from an operational viewpoint, benefiting from market share gains and exposure to growth segments like EVs. The margin improvement is especially reassuring given the dip in 2021 to the bottom of its 9-10% target range. The shares offer good value on 10x current year earnings. ■

Recommendation Updates

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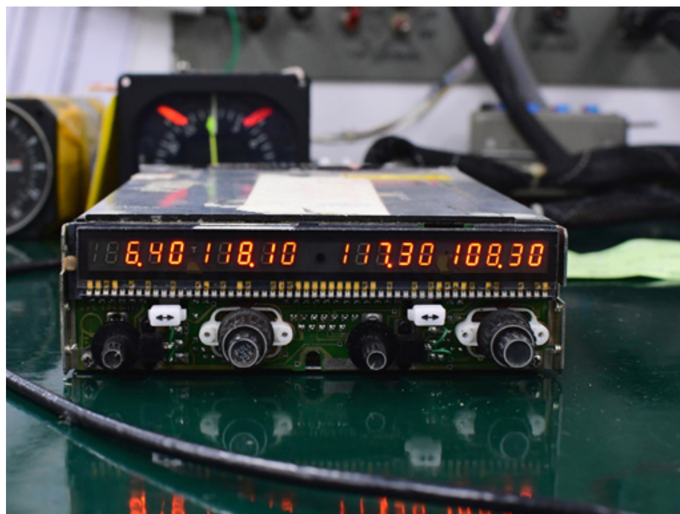
SRT MARINE SYSTEMS — BUY

Date recom'd	Recom'd price	Price now	Gain
Nov '22	34.8p	45p	29%

A downgrade of revenue from £57m to £30m and ebitda from £11m to £2m for the year to March 2023 has been met with equanimity by the market, in fact the shares rose on the news. The company's Systems division deals with foreign government entities and management has described itself to us as a 'passenger' in the process when engaging with them. Once it has submitted a tender it has to wait for the bureaucratic cogs to turn and has no influence over the timing. Similarly when a project is being implemented, SRT can't exert much control over its progress. Material revenue milestones which were expected to complete by the year-end have slipped into the current period – so the downgrade should only reflect timing.

The good news which offset this disappointment is the signing of a formal letter of intent for a new coast guard Systems contract worth £145m. The majority of this project should be delivered over the next two years with "significant revenues" falling in the current year. The total pipeline in Systems is worth £1.4bn with a validated subset worth £535m where discussions are at an advanced stage. The company has also announced the completion of a smaller monitoring system to a SE Asian state which should lead to major projects for an integrated maritime surveillance and intelligence system. When we tipped SRT we argued the Transceivers business alone supported the current valuation. This division is performing strongly, with sales up 58% last year and a major new US distributor agreement announced. Cheap on an £80m market cap. ■



SRT: transceivers business performing strongly

EKF: plenty of upside potential

EKF DIAGNOSTICS — BUY

Date recom'd	Recom'd price	Price now	Loss
Jul '22	33.5p	29.5p	12%

Our tip went well initially, with the stock closing 2022 at 50p for a gain of 49%. However, a disappointing trading update in February has hit the shares hard and we spoke to management after the recent results. EKF benefited from covid-19-related lab testing and contract manufacturing; so the challenge was to replace those revenues as pandemic demand declined. Unfortunately this process was taking longer than expected so these divisions have been rationalised. Contract manufacturing in the UK, which was set up in 2020 in response to covid-19, has been closed. The US Lab Testing business, ADL, has been sold to its management. This was a bad deal: acquired in October 2021 while its revenues were boosted by covid-19, its disposal 16 months later has caused a £9.8m write-off. Total restructuring charges will come to £17.5m, although only ca £1.5m of this will be cash. Net cash at December was £11.4m. CEO Mike Salter has stepped down from his role and has been replaced by Julian Baines who becomes Executive Chairman pending a permanent replacement. US-based Salter is staying on in an operational capacity, in particular to oversee the delivery of the new enzyme fermentation Life Sciences facility which has been a focus of EKF's growth investment.

The core business of point-of-care tests continues to grow and has an attractive business model. Combined with the central lab business, revenues of these established units grew 13% last year to £45m. Having cleared the decks, the priority is to commission and fill the new capacity in Life Sciences. The 4% yield pays us while we wait and a 2024 p/e in the 12-14x region suggests plenty of upside potential from here. ■

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David Thornton goes hunting for stocks offering growth at an increasingly reasonable price

The world according to GARP

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Last month's cover article was called "Screening for Value". It was a response to the seemingly huge numbers of small caps with decent balance sheets and prospects which are trading on single-digit p/es. Small caps as a class have been heavily derated since the bull market ended in September 2021 in the context of a broader UK market which itself trades at a big discount to its international peers. Adjusting for sector distortions (especially the UK's low weighting in tech), Panmure's Simon French suggests UK equities trade at an 18% discount (36% sector unadjusted basis) to the rest of the world. This means small caps are a very cheap segment of a stock market which is itself, very cheap – at least in relative terms.

All equity investing requires patience and value investors need more of this commodity than others. It might take some time for sentiment to turn, or a bidder might short-circuit the process and take advantage of the value offered, as discussed in the Editorial column (see page 3). Either way, buying a solid business on a sub-10x multiple and good yield is likely to deliver substantial returns in the long run ("solid" being an important adjective here).

A particular risk shared by most stocks on last month's value list is that they are cyclical to some degree and therefore vulnerable to an economic downturn. This explains some of the valuation discount and why patience will be needed while we get through this period of economic uncertainty. A classic signal indicating sentiment and fundamentals are turning is when a value stock no longer goes down on bad news – however most of the current newsflow seems okay and forecasts for 2022 and beyond have been framed conservatively. So it feels like we are in a period of limbo. The covid-19 phase rebased forecasts and managements have in general kept a lid on expectations. This implies weak small cap share prices have been driven by lower p/e ratios rather than earnings downgrades.

It might be those lower p/es are merely anticipating downgrades; but the economy continues to be hard to read. The bizarre monetary policy of recent years means current conditions bear little or no resemblance to a conventional cycle. If inflation does abate later this year – the March Budget forecast 2.9% CPI for December 2023 – then we might avoid a recession, or at least one worth the name. Given the extent of the value on offer this seems like a bet worth making.

However as pointed out last time, we are called *Growth Company Investor* and while we cast our net wide, our favoured hunting ground is GARP – growth at a reasonable price. This theme promises outperformance if our stock picking is good, with the prospect of super-charged returns when a stock's earnings growth combines with a rerating. There should be less risk from low quality in this theme compared to value (ie balance sheets and margins are better) and less economic cycle risk. One of this month's New Recommendations, **Argentex** (see page 8), provides a good example of GARP investing.

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Argentex' current year p/e is 12.8x and the stock yields a prospective 2.6%. This is a discount of roughly 10% to the broader market where the median p/e is around 14x, but it stands at a premium to the value basket. Argentex is priced therefore, as a slightly below average stock. Yet it has much better growth and quality factors (high margin, net cash, high ROCE) than average. Earnings growth is forecast to be 25% pa over the next three years which gives us a PEG ratio (p/e:growth rate) of 0.5x. Looking for a PEG below 1x is a handy rule of thumb when evaluating a stock's GARP characteristics. If Argentex makes its numbers and maintains a 12.8x p/e at the end of the period, then we will have made 28% pa including dividends. But there is a good chance it will get a rerating to reflect its premium growth, which will turbocharge returns. For example, if in two years time Argentex is valued on 18x its 2025 earnings which is still only a PEG of 0.7x, then our return would be 160%.

A free upside

GARP comes with a free option on the upside. If the growth comes through without a rerating we do very nicely, if we get the rerating we do extremely well. In contrast, the high growth theme tends to come with a downside risk attached – super premium growth can generate great returns, but a stumble will result in a derating which exaggerates the downgrade.

To screen for GARP I have used Sharescope to identify stocks with low PEG ratios. I then discarded stocks where the growth was distorted in some way or were overly cyclical and those trading on p/es in the high teens and above. Most stocks use 12/24 earnings for the year 2 p/e ratio and I have used the 2023-25 forecast period for the two year growth rate column. These growth numbers and resulting PEGs should be taken with a pinch of salt – we would get a better picture by forming a view of 'normalised' or sustainable growth, which requires some research and subjective judgement. As with all quant screens, further research is needed.

Some of the stocks in the table cross over with the value group but have been left in this screen because they are less cyclically-exposed or have a company-specific story to offset a potential cyclical slowdown. Stocks in this category include **DX** and **Mission Group** which we follow and look anomalously cheap. Along with Argentex from this month's recommendations, **NAHL** (see page 4) also makes the screen. This partly reflects a recovery aspect to the earnings growth but given the year 3 p/e of 4x, a relatively modest long-term sustainable growth rate would likely generate a big rerating. **Warpaint** (see Digest, page 19) already looks attractive on this screen with a 0.8x PEG and we expect upgrades this year will make it even more appealing. **H&T** is held by the GCI Portfolio and looks extremely attractive if it makes forecasts.

STOCKS WITH LOW PEG RATIOS

	Price	p/e yr 1	p/e yr 2	2yr eps growth %	PEG
NAHL	46	17.7	8	315	0.1
DFS Furniture	126	12.4	9.6	100	0.2
Intl Personal Finance	96	5.9	4.9	56	0.2
Argentex	118	12.8	9.9	85	0.2
Capita	34	9.2	7	41	0.3
Kin and Carta	78	9.4	7.7	56	0.3
Robert Walters	408	8.2	6.9	40	0.3
Accrol	32	11.4	9.9	76	0.3
Gaming Realms	29	15.1	11.1	73	0.3
H&T	440	8	6.5	40	0.3
Mission Group	49	6.4	5.8	36	0.3
On the Beach	132	10.1	8.1	42	0.4
ScS	175	12.2	10.4	55	0.4
Yu	595	12.5	8.7	50	0.4
TT Electronics	172	9.1	8.1	29	0.5
Equals	88	16.6	12.9	52	0.5
Premier Miton	88	12.2	10.6	43	0.5
SigmaRoc	56	8.1	7.3	28	0.5
Alliance Pharma	60	11.4	9.7	36	0.5
Gresham House	805	13.7	12.1	40	0.6
DX Group	28	7.1	6.6	22	0.6
Gooch & Housego	516	17.7	14	50	0.6
Luceco	110	12.1	10.4	36	0.7
EKF Diagnostics	28	18	15.1	41	0.7
Warpaint	205	16.9	14.6	35	0.8
Brooks McDonald	1875	12.1	10.4	24	0.9
Strix	104	8.7	7.8	18	0.9
Tribal	39	12.2	10.5	22	0.9
Restore	290	11.7	10.6	23	0.9

Several stocks have stumbled recently for various reasons, which explains their lower than normal valuation. If they are getting back on track and in the early stages of regaining their growth credentials (they have all sold on premium ratings in the past) then there should be a rerating in due course. Names in this group include **Strix** (see last month's recommendation), **Kin** and **Carta**, **Accrol**, **On the Beach**, **ScS**, **Alliance Pharma**, **Gooch and Housego**, **Luceco**, **EKF** (see Updates, page 11), and **Tribal** (see Digest, page 19).

There are several stocks listed that we have not covered recently but might be worth a look. **Yu** has been mentioned to us by a subscriber as interesting and is a stock we should revisit. **Premier Miton** has a big yield and a PEG of 0.5x, while **Robert Walters** and **Intl. Personal Finance** stand out with their low p/e's. To end on a chastening note, I was shocked to see **Capita** had fallen into the FTSE Small Cap index. I remember meeting the company in my fund management days when it was a go-go growth stock in the FTSE 100. I know nothing of the current details and it is still indebted but borrowings appear to be coming down – maybe worth a look but probably more of a recovery story than GARP! ■

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Share news, results and updates

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APTITUDE SOFTWARE Ticker APTD Sector Software Market cap £201m Share price 351p **HOLD/BUY**

The stock has continued to track sideways during a period of product investment which has depressed profitability and contributed to a 50% share price decline from the September 2021 high. The new Fynapse finance automation platform had £4.9m R&D costs expensed last year, up from £1.5m. Spend should peak this year and reduced spend on legacy products will also start to support margins.

The main driver for improved margins further out is the fact that Fynapse is a cloud-native product with higher gross margins (80-85%) and SaaS recurring revenues. T-Mobile in the US has been the launch customer and signed the inaugural contract in December. It provides a 25% revenue uplift on their existing deal and a similar premium is expected when it replaces other on-premise deals.

The sales team is focused on Fynapse and the pipeline is described as very positive with management keen to establish early adopters in banking and insurance. An agreement has also been signed with Microsoft to integrate it into Dynamics, which provides another route to market.

There were also new clients won by Accounting Hub and good scope for growth in subscription management products with the BBC being a major win. The company sees 2022-23 as a transition period with revenues accelerating in 2024-5 when the p/e is forecast to fall to 19x. ■

BELVOIR Ticker BLV Sector Real Estate Market cap £81m Share price 208p **BUY**

The property market is cyclical but Belvoir has two key strengths in this context: the dominance of lettings income (56% of group profits) which is resilient and repeating in nature, and its capital-light franchise model. Demand for rental property is "unprecedented" yet supply is constrained. Lettings agents take a percentage of the rent in fees and the rent on new tenancies rose 11% last year. This inflation will support a rising trend in fee income over the next few years and be fully reflected when new leases are taken out, with the average tenancy lasting 3-4 years. Belvoir is keen to grow its lettings book and targets £5-6m annualised revenue from assisted acquisition this year.

Lettings is offsetting a weaker market for property sales which saw a 10% decline last year (-15% like-for-like). The prior year saw 1.5 million UK housing transactions, which was a post-financial-crisis record, and 2022 represented a return to a more normal 1.2 million. Management is budgeting for a further decline to 1.0 million this year which it believes could be conservative with 230k sales registered in the first 11 weeks. The financial services business would expect to see new mortgages mirror transactions but remortgaging demand is picking up. The company has moved to a net cash position for the first time since 2014 and is keen to progress with corporate and franchise acquisitions. Solid value on a p/e of 11.8x and 4.4% yield. ■

BILLINGTON Ticker BILN Sector Construction Market cap £54m Share price 420p **BUY**

The structural steel supplier had a good 2022 despite Ukraine-related steel supply issues and general cost inflation. The second half benefited from a more stable pricing environment, helped by its steel hedging policy, and a good flow of more complex, value-added projects. This delivered improved profitability with an operating margin of 6.8% compared to just 1.6% the prior year. This trend is expected to continue with revenue growth of 33% forecast for this year and a further improvement in margins to 7.0%. This is underpinned by the strongest order book in the company's history, standing at double the level of a year ago.

The company is three years into a five year capex programme which is bringing efficiency gains, while a concerted recruitment effort has increased capacity to handle complex work.

Large higher-margin projects include energy-from-waste plants (two schemes this year and more next), data centres (23% of the order book) and new film studio construction, all of which require complex steel work. While the overall construction market is expected to be flat, Billington is building a reputation in these high value niches. The shares have had a great run and look overbought, they are also illiquid, so a pull-back would not be a surprise. However a p/e of 8x and 4.8% yield offer value, along with 84p per share of net cash. ■

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BLACKBIRD Ticker BIRD Sector Software Market cap £29m Share price 8p **SPECULATIVE**

Blackbird has been around for a long time during much of which it was known by its former name Forbidden Technologies. Despite its longevity revenue only amounted to £2.8m last year, yet it has a product which seems very seductive from a lay-person's point of view. Blackbird offers cloud-based video editing software which is fast and does not require massive bandwidth or high-end workstations. It allows media companies to deliver professionally-edited content from outside broadcast news or sports events on a timely basis at low cost. However, the media and entertainment sector has been slow to adopt the product and there has been a push into licensing the software to OEMs like the recent deal with EVS, a digital outside broadcast equipment manufacturer. This brings a modest minimum guarantee plus a per-user fee when customers activate the software. Talks are underway with two similar OEMs.

CEO Ian McDonagh believes the bigger opportunity now lies in the much larger (estimated 150 million potential users) 'prosumer' and 'pro-teams' market of content creators making video films, podcasts, and corporate content. The company plans to release a self-service SaaS product to address this market in Q4. The aim is to displace basic cloud editing tools or more expensive Adobe and DaVinci offerings. There is a cash runway to the end of 2024. We should get some broker forecasts released soon. ■

DESTINY PHARMA Ticker DEST Sector Biotech Market cap £34m Share price 35p **SPECULATIVE BUY**

Biotech stocks have been out of favour for some time but Destiny's valuation seems to be at odds with its advanced product portfolio. It has partnered NTCD-M3 for the prevention of c-difficile infections with US-based Sebela Pharma (private equity owned) who will fund phase 3 trials expected to commence next year.

Peak sales are expected to be $500m with approval possible in 2027. There is $19m in development milestones and a 10-18% royalty rate on sales. Destiny retains the right to licence the product outside the US.

A recent £7m fundraise buys the company more time to find a development partner for its lead product XF-73 for the prevention of post-surgical infection. This could be a $1bn drug and there is an active process to find a partner to run a phase 3 trial also to commence next year.

This follows positive phase 2 data and management has identified with the regulators routes to approval in both the US and Europe. Ideally a partner deal will bring sufficient cash up-front to support the running of the business and avoid the need for further placings. News on this should generate interest in the stock.

Broker finnCap has a risk-adjusted DCF value of 285p, while a simple glance at the £35m market cap suggests there is plenty of upside should just one of the products be successful. ■

FOCUSRITE Ticker Tune Sector Leisure Goods Market cap £310m Share price 525p **HOLD**

The interims to February saw a 16% revenue decline in the Content Creation brands, partially offset by the ongoing recovery in the Audio Reproduction side which had suffered due to the cancellation of live events during the pandemic.

The main issue has been an inventory cycle combined with slowing demand. Four months is normal channel inventory but this fell to 1.5 months due to a strong market and component shortages during FY2021 and the first half of FY2022. Supply constraints have eased and inventories have now been rebuilt into a softer market.

Focusrite is also managing down older stock ahead of new product launches this summer. Accordingly there is a lot of promotional activity which is being funded by a welcome decline in freight rates; so gross margins were able to rise 50bps.

Adam has recovered from the component shortages which had hampered sales and Audio Reproduction grew 51% (25% organic) as Martin benefited from the return of live events. Demand here is expected to remain strong. There has been a big swing from £18m net cash to £13m net debt due to £7m acquisition spend, working capital, and reduced profitability. Having attained a p/e in the 30s during the bull market, the stock now trades on a much more reasonable 13x. The stock is still in a downtrend: no rush to buy but well worth putting on the watch list. ■

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INSPIRED Ticker INSE Sector Support Services Market cap £93m Share price 9.5p **BUY**

The shares have been derated from the 12x they traded on a year ago to the current p/e of 6.9x, despite earnings forecasts being broadly unchanged over this period. The trading backdrop has been difficult with Assurance clients hit with big energy cost increases where hedges have only offered partial protection. So there was client churn (80% retention rather than the more normal 85%) but also record levels of new business with some big wins. Management expects stable or modest growth this year with a 43-45% ebitda margin against 45% last year.

Optimisation is now the largest division and demand should remain very strong as clients look to reduce energy costs and fulfil ESG commitments. Growth will come from new clients and particularly cross-selling the full suite of services. While Optimisation tends to be project based, big customers can provide large, repeating revenue streams – for example one Assurance client has spent £24m over 13 years on projects with a further £4.7m planned. The aim is to double organic Optimisation revenues over five years by farming the Assurance client base. ESG is still small but should move into profit this year and has strong long-term growth credentials. Cash conversion improved last year but debt will remain relatively high (£42-43m) due to deferred acquisition consideration falling due this year and next. Out of favour but cheap. ■

MICHELMERSH BRICK Ticker MBH Sector Building Materials Market cap £89m Share price 93p **BUY**

Like most property-related stocks Michelmersh has been derated but the fundamentals continue to look solid. Brick making is energy intensive and the company mitigates the impact of volatile prices by hedging 90% of its requirements. Management says it has cover for 2024 and 2025 at good levels, but its main motivation is to provide customers with certainty from being able to set prices at the beginning of the year.

The product range is biased to higher-value premium bricks which are architect-specified, rather than mainstream bricks favoured by volume housebuilders. New-build residential accounts for about 25% of revenue, with RMI (repair, maintenance, improvement) and commercial both larger segments. This provides a good balance to the business. Results for last year were ahead of consensus with profits up 15% and margins maintained.

The order book at the start of this year is described as "high quality" with "order intake momentum continuing into the first quarter". The company has broadened its specialist offering further by acquiring FabSpeed late last year. This business provides a range of pre-fabricated brick products and will use a surplus Michelmersh site to expand its output. Management has maintained a conservative balance sheet with £10.6m net cash and the shares offer good value on a p/e of 8.9x and 4.6% yield. ■

MARKS ELECTRICAL Ticker MRK Sector Retailers Market cap £91m Share price 87p **BUY**

Marks continues to defy a tricky backdrop for consumer goods as it takes market share and demonstrates strong growth. The trading update for the March 2023 year showed revenue growth of 21.5% with the fourth quarter delivering 20%. Momentum continued through the end of the period with the month of March up 21%. For context, the overall market was down almost 10% last year.

The company's success is being helped by growing brand awareness, though this is still at a very low level outside its Midlands base, standing at less than 10% in all other regions. The company's proposition is service-led, with next-day delivery and an installation option – the latter is often financially supported by manufacturers who are keen to protect their brand by having high-end products properly installed.

Another area of growth is the TV segment where Marks has been a weaker player: a bigger, more authoritative range is seeing it make good headway in the category.

Costs seem to be well controlled with wage inflation expected to be around 4% this year after a 9% rise for 2022. Drivers get a £5 per positive Trustpilot review, which can add up to a nice bonus, incentivises good service, and is an effective form of marketing spend.

The shares trade on a mid-teens multiple, but self-financed 20% growth deserves a premium rating. ■

The GCI Digest

MISSION GROUP Ticker TMG Sector Media Market cap £45m Share price 49p BUY

The Mission looks to be exceptionally cheap but like many microcaps it is difficult to identify a catalyst. Patient investors get a prospective yield of 5.9% while they wait for the shares to rerate from a lowly p/e of 6.4x. The company does carry acquisition-related debt on its balance sheet but this is forecast to decline rapidly after this year when the remaining earn-out commitments will have been paid.

At the 2022 year end the leverage ratio stood at 1.2x with net debt of £11.4m. Net debt is expected to fall to £5m in 2024 with a net cash position the following year.

The valuation looks even more anomalous when we look at growth forecasts. The company expects to get to £100m revenue by 2025 having invested in its platform and established a more coherent group sales strategy, whereas previously it was a collection of discrete agencies.

Margins should improve as the central shared-services costs are spread across more revenue and there is scope to increase higher-margin creative and planning content in the mix. Forecasts have operating margins improving from 10.8% to 13% over the three year forecast period. Before the pandemic management suggested 14% was attainable; so this should be a reasonable target. This implies eps growth of 15% pa over the next three years and a PEG ratio of 0.4x. ■

QUIXANT Ticker QXT Sector Technology Market cap £115m Share price 173p BUY

Quixant has had a tough few years, being something of a fallen stock market star. The shares hit a high of 480p in 2018 as a highly-rated, cash-generative growth stock. Its leading customer then hit problems and the casino industry suffered badly from covid-19 lockdowns. The business is now recovering nicely with revenues from gaming machine hardware and software platforms growing 57% last year, which along with 15% growth at Densitron helped take group revenues ahead of the previous 2018 high. This was achieved despite component shortages, with the company managing to deliver more of the order backlog that had built up than originally expected.

The US had a strong second half led by Las Vegas; while Europe recovered sharply after a more subdued 2021. High-end products did well and margins were maintained with cost increases passed through. Demand will normalise but the trend to outsourcing favours Quixant and it is benefiting from growth in high-end products as well as its new turnkey cabinets.

We were unconvinced by 2015's Densitron deal and the division showed little growth in its early years; however its diversification is a help and growth has clearly picked up in the last two years. Broadcast is an interesting new market and the screens business is growing solidly. Decent momentum and good value on a prospective p/e of 12.7x for 13% growth. ■

THOR EXPLORATIONS Ticker THX Sector Mining Market cap £125m Share price 18.5p BUY

Thor began construction of its Segilola, Nigeria gold mine in early 2020 and first production was July 2021, 16 months after construction started. Last year saw 98k ounces produced which was ahead of expectations.

Nigeria is a favourable jurisdiction for mining with the government keen to diversify away from its dominant oil and gas industry and CEO Segun Lawson says Thor has first mover advantage in an underexplored region. The drawback is the short life of the mine with only four years production in prospect. There is scope to go deeper in the existing mine and the company has nine drill targets nearby with two underway as it seeks to extend the resource. Successful mine-life extension would obviously have a significant impact on the stock. The company is forecast to have $122m net cash by 2024, rising to $282m at the end of 2026. Broker estimates have an NPV of 34p.

The company also owns 70% of Douta in Senegal, which is lower grade than Segilola but a bigger project. The global resource is estimated at 1.78 million ounces and a priority is to upgrade the inferred element and deliver a preliminary feasibility study by year end. This project could be funded from cash and debt and produce $70-80m free cash flow pa if successful. Plenty of value and management are shareholders who are keen to initiate dividends before long. ■

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TRACSIS Ticker TRCS Sector Technology Market cap £284m Share price 950p **HOLD**

Having been an acquisitive, founder-led business, Tracsis is evolving under CEO Chris Barnes into a more focused group with a 'single company' philosophy. This should help the business share best practice, bring efficiencies through shared services and an improved IT system, and drive growth through clearer leadership. UK Rail is currently performing strongly across the board. Monitoring equipment is in demand ahead of the final year of the industry's current control period. The second TRACS Enterprise product has been deployed and the Hub roll-out now has 40,000 users. Opportunities are coming from the smart ticketing initiative and the formation of GB Rail which will bridge infrastructure and the train operating companies. The relatively new US arm had a strong first half due to its 'positive train control' contract. US interest in condition monitoring, Enterprise, and timetabling products is building.

As part of the restructuring the Data and Events businesses have been merged and demand has normalised post-covid-19. The company has also merged Data Analytics, GIS and Transport Insights, with data-as-a-service seen as a big opportunity. Having established a footprint in the US, the focus for future M&A is to acquire a rail business in Europe. Rail and transport data should remain solid growth industries and the overall strategy is coherent. Unfortunately the valuation remains relatively full with a current year p/e of 25x. ■

TRIBAL Ticker TRB Sector Software Market cap £85m Share price 40p **SPECULATIVE BUY**

Tribal has been hit by its big contract with a Singaporean university (NTU) which went wrong in the second half of last year. Tribal's software has not been the problem, rather the scope of the project had been changed by the client who introduced significant extra work and complexity into the contract. NTU has now terminated it at a point where Tribal had done 60% of the work. Tribal argues that the termination is "wrongful" and the parties have gone to non-binding mediation – as yet there is no clear timetable for resolution of the dispute. There could be "a significant adverse financial impact"; alternatively Tribal could gain compensation.

The company is also "considering its strategic options" for the Education Services division which is performing well but only represents 18% of group revenues.

Core annual recurring revenue (ARR) grew 10% last year, though this growth was offset last year by declining legacy products. Revenues will be enhanced by more clients moving to cloud managed services over time; management says there is an additional £15-20m of ARR to come from this migration.

The core business is in transition and we have the NTU uncertainty to further confuse things; however, the stock trades on 7.4x ev:ebitda, a p/e of 12.5x and an ev: sales ratio of 1.1x. ■

WARPAINT Ticker W7L Sector Personal Goods Market cap £150m Share price 205p **BUY**

We tipped Warpaint last October at 125p and followed up in December's *GCI* with a report on a company visit we made. Impressive results for last year have just been announced with sales growth of 28%.

Europe was the star, up 56% to £28m, which represents 44% of group revenue. There are a couple of key relationships with growing retailers which is driving this success but this is now starting to broaden out as the brand gets more visible.

The US is also getting good traction from a lower base and grew 55% in local currency. Once sales get to a critical mass (ie $15-20m) the company will open a warehouse and take logistics in-house.

The UK grew 9% last year and the outlook is positive – there are new relationships with Asda and New Look, while Boots is said to be going very well. Online is small (4.3% of group) but also building nicely, with sales doubling.

Importantly, momentum is strong with the first quarter of 2023 seeing impressive 40% revenue growth at a higher margin than last year's 15%. Q1 is seasonally quieter but still accounted for 20% of the 2022 total – if it generates a similar share of this year's revenue then annual sales would be over £90m rather than the £74m broker forecast – so upgrades seem highly likely as the year progresses. ■

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The GCI Portfolio

A few modest gainers give David Thornton some small cause to celebrate an otherwise indifferent month

A lacklustre month with the Portfolio trailing both benchmark indices. I was slightly surprised to see AIM up 3.2% and a quick check shows the median stock in the index was unchanged over the month.

On a cap weighted basis the index was helped by Burford rising 78% since we last wrote to become the second largest stock on AIM with a market cap of £2.2bn (Jet2 is the largest at £2.6bn). That is interesting but does not excuse our continued flat performance – it is proving very hard to generate any traction.

Risers

We had two double-digit fallers and one riser over the month. The gainer was **Sanderson Design**, up 11.6%. It has just reported results for the year to January and we are due to speak to the company next week so will report next month. The company performed resiliently last year in a difficult environment which augurs well for when conditions improve.

Serica rose 7% but the sector remains out of favour. The company announced a 22p dividend in respect of last year which puts the shares on a 9% yield; so at least we get paid while we wait.

Renold was a modest gainer over the month but the shares remain stuck below the 30p level which they breached in late 2021 but now feels like tough resistance. We had a positive trading update on 17 April confirming the strong momentum of the first nine months continued through the year end. Revenue grew 19% at constant FX, 13% organically.

Trading profit and margin will be materially ahead of previously upgraded forecasts with the broker forecasting 5.8p for the year ended in March giving a p/e of 4.6x. Order intake grew 10.6% over the year and the order book closed FY2023 18% higher than it stood at the start.

Oddly, or possibly conservatively, the broker forecasts a 3% revenue decline for the current year. This time last year the stock was valued on a p/e of 7.5x and has beaten the earnings forecast made at that time by 57% – you guessed it, the share price is unchanged!

As observed in the cover article (see page 12), you need to be patient in this game.

RETURNS TO 26 APRIL 2023

	Since last month	Since inception (20/10/15)
GCI Portfolio	0.1%	143.3%
FTSE All Share Index (total return)	4.0%	61.4%
AIM All Share Index	3.2%	10.3%

PORTFOLIO SUMMARY (starting capital £60,000 on 20 October 2015)

Stock	Holding	Purchase date	Purchase price (p)*	Purchase cost (£)*	Current price (p)	Current value (£)
Motorpoint	4,214	19/12/19†	282	11,967	137	5,773
Somero	3,788	26/1/16†	158	6,017	329	12,463
Niox	33,906	23/6/21	29.75	10,097	45.3	15,359
On the Beach	2,159	20/5/16†	178	11,043	132	8,118
Bioventix	276	21/2/18†	2,140	5,921	3,805	10,502
Sanderson Design	12,645	25/11/20	78.5	9,936	135	17,008
Argentex	8,331	26/4/23	117.5	9,799	117.5	9,789
Renold	76,500	25/11/20	13	9,955	26.9	20,578
R&Q Insurance	8,667	27/10/21†	188	12,995	62	5,374
Equals	11,000	25/8/22	94.25	10,383	88.6	9,746
H&T	2,280	25/8/22	461	10,521	440	10,032
Serica	2,890	28/10/22†	312	9,015	239	6,901
CentralNic	5,805	23/2/23	133.5	7,760	116	6,757
DX Group	27,637	23/2/23	28	7,748	27.5	7,600
					Cash	0
					Total	**145,999**

** Adjusted for partial sales and additions; † added to or reduced holding subsequently.*

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Fallers

Turning to the losers, **R&Q** fell 12.7%, revisiting the lows after a decent bounce in the first two months of the year. It has announced a legal separation between its fast-growing Program Management arm, which is why we bought the stock, and the legacy insurance operations. This should bring more clarity to the business, especially when valuing the two distinct parts to the group, and could ultimately open the door to a disposal or demerger.

A trading update showed a strong performance from Program Management offset by fewer transactions and adverse claims in legacy.

The management structure has also been clarified with William Spiegel CEO and new chairman Jeffrey Hayman, an industry veteran who was also a recent board member of Zurich Insurance.

CentralNic fell 10.8% despite an upbeat trading update and new Microsoft contract. However, growth looks to have slowed from last year's stellar levels – we are due to speak to management next week to get more detail.

Portfolio changes

The **Kape** offer has gone unconditional so we will sell and replace the holding with **Argentex**. ■

Please do bear in mind that this is purely an exercise. We hope you find it interesting; but the GCI Portfolio does not constitute investment advice and will not be suitable for everyone. Actual 'real world' results might differ from those presented in the magazine. Individual investors should always seek personalised investment advice from a professional. The GCI Portfolio includes dealing costs and dividends.

Market Outlook

April may have been an improvement on the preceeding month but markets still seem to be in limbo and patience is essential

A uniformly better month after March's horror show which saw the various UK indices in our table lose between 4.0% and 8.9%. We concluded last month's column by observing that we should not get overly gloomy after a bad month – the previous month we also counselled against getting too upbeat after a good move in the markets. Our view remains that we are in a sideways market for now, the word 'limbo' which crops up in the cover article, seems apt.

One important point to make is that the October lows look increasingly like the bottom. Most of the indices in the table have held comfortably above those levels and we are now seven months down the road, which represents some decent base-building. The one index which came closest to testing the low was, of course, AIM. AIM's low on 28 March was a mere 2% above the 13 October bottom, in contrast the March low in the FTSE 250 was a comfortable 10% higher than October. That nicely illustrates the relatively poor price action and sentiment stalking our universe. 'Patience' is another word which makes a couple of appearances this month and that is a virtue we must adopt.

Our cover articles screening for GARP and Value have been interesting exercises. These are far from exhaustive lists and could be extended and refined to capture more names. The point is that there are plenty of very attractive stocks out there and if we do not buy them then, as the Editorial suggests (see page 3), private equity or trade buyers will.

Inflation feels like the key to the longer-term future and here again we are having to be patient with the March print a still woeful 10.1%. So far the bond market appears relaxed with yields remaining in a narrow range around 3.5% this year; while falling energy prices and a weaker dollar will be helping.

The most eye-catching number in the table is the Nasdaq Composite's 16% year-to-date return. We would not normally expect the old bull market's leading theme to be in the vanguard of a new bull market. However, this rise is narrowly based and led by mega caps. Meta (aka FaceBook and ninth largest US stock) is up an astonishing 98% this year, while the three largest US stocks Apple, Microsoft and Alphabet (aka Google) are up 30%, 27% and 22% respectively.

In contrast, the S&P 600 small cap index has so far returned -2%. So the small cap malaise is not just parochial, and if we can be patient, maybe stock markets will broaden out in the coming months. ■

CAPITAL RETURNS TO 27 APRIL 2023

	AIM	FTSE Small Cap (ex. ITs)	FTSE Mid-250 (ex. ITs)	FTSE 100	S&P 500	Nasdaq
1 month	3.0	3.2	4.6	4.8	4.0	3.2
Year to date	-1.1	-0.6	3.4	5.1	7.7	16.0
1 year	-19.1	-12.6	-5.4	5.5	-1.1	-2.8
3 years	3.5	42.1	22.7	34.0	43.7	39.1

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Best of the Blog

One of last month's New Recommendations has announced an acquistion that could prove transformative

We wrote a recommendation piece in April's *GCI* on **Franchise Brands** (AIM: FRAN) which concluded: "We should be aware that an acquisition-related placing is possible at some point and the shares have had a great move – so one to keep a close eye out for buying opportunities."

Vigilance was not required for long. On the second trading day after publication, the company announced the £212m acquisition of Hydraulic Authority I Ltd, which is the owner of Pirtek Europe. The deal was funded with a £114m placing at 180p, which was a discount of 25%, and the shares are currently trading just below this level at 178p. The impact of the deal is shown in the table using estimates from the company's broker which suggest 6% earnings accretion for 2024:

Y/e Dec	Sales	Pre-tax profit	eps	Old eps	p/e	Yield
2022	99.2	12.8	8.4	–	21.0	1.1
2023	155.1	21.5	9.3	9.3	19.0	1.3
2024	182.1	28.3	11.0	10.4	17.0	1.4

The discount dilutes shareholders unable to participate in the placing, while the advantage for the company is that it allows funds to be raised more quickly and cheaply than a traditional rights issue. However, for potential new holders who were keeping 'a close eye out for a buying opportunity', the prospective p/e of 17x looks much more appetising than the 22.5x pre-deal valuation for the stock quoted in *GCI* last week.

Growth opportunities

Pirtek has 70 franchisees who operate from 213 locations in eight European countries (including the UK and Ireland which accounts for 40% of the van fleet, Germany is 38%, Benelux 12%, and France 5%). It uses 838 vans to provide on-site hydraulic hose replacement and related services, which are mission-critical and carried out on a one-hour emergency response basis.

Franchise Brands identifies several growth opportunities for Pirtek: geographic expansion into further countries and increasing its presence in existing territories; expanding the range of services offered; and using technology to increase efficiency. The deal is consistent with chairman Stephen Hemsley's strategic aim to add a significant European leg comprising franchised, B2B, van-based services.

Pirtek management is staying with the company and its CEO Alex McNutt is joining the Franchise Brands board. McNutt and his colleagues are also investing in the placing, while Hemsley and major shareholder Nigel Wray are each putting in *ca* £1m.

Given the cash generative nature of the franchise model, the deal is being part-funded with debt and the company forecasts a leverage ratio of 2.3x net debt:ebitda for the end of this year, falling to 1.6x next. Broker forecasts continue this trend with the ratio falling to 0.3x by 12/26. Furthermore, net debt is expected to be £75m at the end of the current year but this could be meaningfully reduced if the B2C division is successfully sold since proceeds could exceed £20m.

Pirtek sales slipped 8% during the March 2021 year from £133m to £123m but recovered to 9% above pre-pandemic levels in 3/22 and are expected to have grown an impressive 17% in the year just ended, with an ebitda margin in the high 20s.

"Franchise Brands' business model and its board are worth backing. With this anticipated major deal... we would be happy to buy the shares at the current level"

Franchise Brands has had success in driving growth at Metro Rod through improved IT systems and expanding the offering, so having gained that know-how in B2B van-based services, it is reasonable to expect synergy benefits beyond what is shown in current forecasts. Eps growth for 2024 is forecast to be 18% implying a reasonable PEG ratio of 0.9x

As pointed out in our original *GCI* recommendation at 68p in Feb 2018 and reiterated in this month's issue, Franchise Brands' business model and its board are worth backing. With this anticipated major deal now announced we would be happy to buy the shares at the current level. ■

AIM Newcomers

Company	Sector	Adviser	Type of issue	First dealings	Market cap (£m)	Issue price (p)	Funds raised (£m)
Onward Opportunities	Invesrtment Cos	Dowgate Capital	Placing	30/3	12.3	100	12.7

AIM Movers – 1 month to 26 April

AIM 100 index

Risers	%
Burford Capital	77.5
Atlantic Lithium	29.4
PetroTal	28.1
Mortgage Advice Bureau	21.8
Greatland Gold	19.3

Fallers	%
Ienergizer	-82.0
Franchise Brands	-28.0
Focusrite	-26.4
Pantheon Resources	-24.7
Team17	-23.3

AIM All-Share index

Risers	%
ESCS	156.1
eEnergy	127.8
Kodal Minerals	126.3
Saietta	107.9
Zanaga Iron Ore	102.6

Fallers	%
Ienergizer	-82.0
Biodexa Pharma	-80.3
Circle Property	-78.3
Woodbois	-65.5
DeepVerge	-62.6

Companies in this issue

Companies mentioned	Section
Aptitude Software	Digest
Argentex	New Recommendations
Belvoir	Digest
Billington	Digest
Blackbird	Digest
Churchill China	Updates
Destiny Pharma	Digest
EKF Diagnostics	Updates
Focusrite	Digest
Inspired	Digest
Marks Electrical	Digest
Michelmersh Brick	Digest

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Public Policy Holding Co	New Recommendations
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Tracsis	Digest
Tribal	Digest
Volex	Updates
Warpaint	Digest