THE SMALL COMPANY

SHARE WATCH

November 2023

MARKET COMMENT

This time last year we expressed sympathy for one UK fund manager who told us that "many stocks in the UK are on sale at valuations we have NEVER seen before." Since then they have become even cheaper. This week another outstanding UK fund manager added more colour to this conundrum: "More than 45% of the UK stock market trades on a forward PE of less than 10x. Just 5% of the US market falls into that valuation bucket." The comparison could not be starker. There is a lot of bad news priced into the UK market.

For such fund managers, the good news is that they can build decent portfolios out of undervalued businesses. The problem is that they hold 50-100 such businesses. A handful might do very well but with markets going nowhere, on average the outcome is the same for their funds, until we get one of the catalysts we mentioned back in August and September, when a rising tide will lift all boats.

The better news for you is that you can be selective, giving you an edge over the fund managers. The point is that this is now a market for stock pickers, because there are always some stocks that can drive ahead despite wider torpor, such as Good Energy, which was highlighted last month and has already shot ahead 20%.

On which note, we include a number of other features this month (eg. Future on a prospective PE of 5.6) and will be exploring more of the same between now and the always exciting New Year NAPs. Looking more broadly, the last month has been a difficult one for markets. Nerves were already apparent, particularly due to concerns over US Treasury yields spiking higher. Now tensions in the Middle East have added to these, particularly the risk of escalation. As you might have expected, gold responded positively but nothing else. Domestically, the UK's FTSE-250 index broke down through the clear support at 18,000 and carried onwards down to 16,800.

The factors influencing markets are typically complex, now more so than ever. You don't need to spend too much time predicting the likelihood of recession or global debt crisis, nor calculating the remote chance of Iraq blocking the Straits of Hormuz nor Russia using nuclear weapons in Ukraine. All you can do is control what you can control. In terms of risk management this means having an exposure to investments that tally with your own attitude to risk (e.g. how much can you afford to lose?) and having a stop-loss strategy.

TRISTEL (TSTL)

Sector :	AIM, Health Care	
Latest Price :	400p	
High/Low :	450p - 290p	
Market Cap. :	£189.6m	
Shares in issue:	47.4m	
end6/2023 EPS/PER est	13.6p	29.4
end6/2024 EPS/PER est	17.3p	23.1
end6/2025 EPS/PER est	20.5p	19.5
Contact	01638 721500	
Registrars	03707 020003	
CALENDAR		
Int/Fins/AGM	FEB/OCT/DEC	

Tristel is a manufacturer of high level sterilisation liquids and single use wet wipes based on its proprietary chemistry and used by the NHS to sterilise medical instruments and hospital surfaces. The company's growth has been supported by the high number of cases of hospital-acquired infections (HAIs), which come about as a direct result of surgical treatment, or from being in contact with inflected floors and mattresses. HAIs lead to an increase in the cost of hospital care, as infected patients require longer bed stays and additional treatment. In the US, the cost of this alone to the industry is estimated to be US$45bn!

As the company tells me, last year there were 17m disinfection events using Tristel's chemistry compared to 15.7m the year before. But the short run reason for me to Buy rate the shares is that in June, the company was granted approval by the US regulatory authority for the immediate sale of its ULT disinfectant (*Tristel Duo ULT*) for ultrasound instruments. The process cost around £3m and took time as Tristel had to convince the FDA of the merits of a new method.

Sales into US begin - a market 10x bigger

This means it can now immediately start selling into the world's largest ultrasound market, with 215 million annual procedures, of which around 20%, or 47 million scans, are in orifices and require high-level disinfection. Ultrasound is already 50% of Tristel's business, and given that the US health emergency was declared over in May following three years of disruptive restrictions, I think there is a significant backlog for diagnostic imaging, tests and procedures.

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2023 WINNER Journalist of the Year

US opportunity significantly derisked

US contracts in the coming weeks are therefore likely. One broker (Numis) suggests Tristel could more than double its revenue and profits over five years, with the base business supported by the backlog of diagnostic procedures. Based on pretax profit of £8.1m this year and £10.2m next, corresponding earnings per share of 13.6p and 17.3p might not appear to be particularly cheap but the broker has not factored in the potential from the US, which leads me to believe that it could supercharge performance. As I describe below, Tristel has already licensed the technology to a specialist US partner with the financial muscle and presence to develop the market. The resulting royalties, combined with a modest cost structure, could generate spectacular profit growth.

During the month I caught up with chief executive Paul Swinney, a former stockbroker who cofounded the business in 1990 together with another banker.

As he explains, steam can be used to sterilise some devices but it isn't suitable for all devices, such as those that are heat or moisture sensitive such as ultrasound probes, pachymeters (used to measure cornea thickness) and tonometers (used to measure intraocular pressure). In those cases alternative cleaning technologies are used including UV light, hydrogen peroxide plasma gas, ethylene oxide and chlorine dioxide (ClO_2) - the latter being the chemistry behind Tristel's disinfection.

Originally used in water treatment and the paper industry, it is well known that CIO_2 has proven efficacy against a range of microbial, fungal and viral organisms. Its potent biocidal effect is achieved through oxidation, attributed to its unique ability to penetrate the microorganism's 3D protein structure and better oxidize the molecules.

Tristel has spent two decades exploring the potential of ClO_2 for reprocessing reusable medical instruments and for cleaning hospital surfaces (sporicidal) to protect patient safety as these are the two main causes of HAIs and it's now the only one making and supplying a range of proprietary disinfecting foams based on this chemistry and as Swinney tells me, the broad biocidal activity of CIO_2 makes it effective in destroying all types of bacteria (including spores), tuberculosis, MRSA, fungi and viruses, relatively safely and easily.

Patent protected chlorine dioxide chemistry

But even though some of its patents ran out in 2015 (there are 60-odd of them), the secret formulation, knowhow and regulatory approvals have kept competition out and Tristel enjoys high market shares.

As I am learning, the products are formulated as a two-part system, which when mixed produce chlorine dioxide. The first part is a sodium chlorite solution and the second part comprises an organic acid blend, corrosion inhibitors, buffers and preservatives. By mixing the two parts, chlorine dioxide is generated in aqueous solution. The active solution can't be stored, so it has to be created at the point of need.

The key features of Tristel's technology is the speed of the reaction to generate chlorine dioxide and the fact that the reaction takes place in a pH neutral environment (5.5 – 6.5) compared to most other aqueous systems, which operate in highly acidic conditions. This allows it to be used at the point-of-care rather than having to send instruments to a central sterile services department (SSD) located either within or near the hospital. What is also helpful is that using oxidizing biocides like ClO_2 prevents microorganisms from developing resistance. Additionally, ClO_2 produces no hazardous by-products and is less harmful to people and equipment compared to other biocidal chemistries such as hydrogen peroxide and chlorine.

86% of sales instrument decontamination

Tristel's leading product group is its range of solutions for disinfecting medical instruments under the *DUO, TRIO* and *Stella* brands and instrument disinfecting accounted for 86% of the £36m sales last year.

Swinney has been targeting a well defined set of instruments since its solutions were introduced to the UK market in 1995 as a replacement for the chemical 2% glutaraldehyde, which had been the universally used disinfectant for flexible endoscopes before concerns with its toxicity led to the search for safer alternatives.

Flexible endoscopes had historically been difficult to effectively disinfect as they have lumens, which require disinfectant to be pumped through them. As he says, such medical devices are reusable as single-use devices are costly and not environmentally sustainable. But being made of plastics and polymers, they cannot be heat sterilised and Tristel's range of solutions allows them to be disinfected by hand (rather than being put through a washer dryer). In terms of share, Tristel's products are currently used to decontaminate endoscopic and ultrasound instruments in 50% of all applicable UK hospitals.

But using 20ml bottles of liquid isn't always that convenient so a few years ago Tristel developed a single use wipe system, initially comprising a tub of wipes plus the activator foamer but now it sells individual impregnated wipes in a sealed sachet with traceability labels. This has helped open up uses in other diagnostic procedures involving small, heat-sensitive medical instruments such as nasoendoscope used in ear, nose, and throat departments and also opthalmology.

Surface cleaner

Alongside all that, Tristel has developed a surface cleaner for general hospital use to clean mattresses, floors and walls especially in the high-risk areas of the hospital such as intensive care, burns units, organ transplant units and oncology. While the cleaning and disinfection of surfaces in hospitals is widespread, even before Covid, global spending by hospitals in this regard far exceeded that for decontaminating medical devices. Tristel's surface cleaners only represent c.11% of sales whilst it awaits CE marking to allow it to be sold in Europe.

The *Cache* range comprises a two-part foamer, which carries and keeps separate the reagents until dispensed and these are routinely used as a surface sporicidal agent available to hospitals to control Clostridium difficile infection, which is responsible for outbreaks of diarrhoea in hospitals and also other common hospital-acquired infections such as MRSA, acinetobacter and Norovirus.

In an interesting development, Tristel has also launched an App that allows hospitals to record all steps of the decontamination process and by incorporating Ai, it ensures all steps are correctly carried out.

Geographical opportunity

Instrument and surface solutions and wipes have historically been manufactured by itself and a simple combination of mixing the ingredients in vats allows the company to keep overheads and capital expenditure low.

The products are then sold directly by Tristel's own direct sales force in the UK, EMEA and

Editorial shareholdings of companies covered in this issue: Volex, Reach, Frontier Dev, Supreme and THG

APAC as well as distributors elsewhere. Tristel has historically grown revenues by building market share in Europe and the UK. The UK is its largest contributor to revenue (approximately 35%) whilst distributors sell into hospitals in the UK, Europe and the APAC region, currently representing £2.8m or 7.8% of sales. Using a distributor to build a local presence isn't that unusual as Tristel has historically allowed them to do that before gobbling them up, with 6/7 such deals over the years.

When it comes to the US, Swinney has taken this low risk approach and entered into a commercial partnership with US-based Parker Labs, to both manufacture and distribute its disinfectant foams for the US. Under the exclusive agreement, Parker will manufacture and distribute Tristel DUO. To avoid any vagaries of fluctuating raw materials, the deal has been structured so that Parker will pay 24% of invoiced sales to Tristel.

Obviously, there is a need for some caution. Parker needs to gain traction and persuade hospitals to use CIO2. Most hospitals are currently customers of Nanosonics, the market leader in disinfecting ultrasound equipment that makes Tropon hydrogen peroxide plasma gas instruments. Nanosonics has an installed base of Tropon instruments for which it supplies chemicals and could start to slash its prices to retain market share. For hospitals who adopt Tristel, there is no requirement for instruments as the foams are applied by hand and the cost will be comparable to Tropon consumables. Parker already sells an FDA approved ultrasound gel and has all the US manufacturing accreditations and it plans on exhibiting at seven major USA conferences next year. I suspect it will be three or four months before things start humming.

As a guesstimate based on a comparable end user price of c.US$3 per disinfection (c.US$48 cents to Tristel) and based on it taking a 33% share of potential ultrasound HLD scan procedures, this equates to sales to Parker for Tristel ULT of c.US$33m by FY 28. This would imply royalties of US$7.9m for Tristel.

Royalties will be included within the revenue line and is why Tristel's margin could increase even beyond the mouthwatering 81% gross margin and the 25% EBITDA margins being delivered in the latest year. This increase will primarily be driven by a change in product mix from being historically focused on lower margin manufactured solutions to greater contributions from higher margin royalties.

Costs include negligible R&D spend, whilst sales, general and administrative spend are also unlikely to rise significantly over the next few years. All this makes for spectacular growth potential once the US contracts kick in. There should also be further largesse for shareholders in the form of rising dividends (latest year saw the dividend lifted by 10% to 10.5p) with net cash set to climb from £9.5m presently. *I am a buyer ahead of contract newsflow.*

UPDATES

Volex (VLX) 282.5p

Sector: AIM, Electronic & Electrical Equipment

Volex has issued a short H1 preclose update. Despite strong comparables, revenues for the first half of the year were 4% higher. The US$195m acquisition of Murat Ticaret completed during the final month and moves the dial in terms of scale, margins and end markets/geographic diversification by adding a business with off highway manufacturing exposure. It has already bedded in well and initial customer engagement has been very encouraging with opportunities to realise cross-selling for the wider group.

The business is getting well spread across a number of sectors, which insulates it from any one turning down - so right now Medical and Complex Industrial Technology have performed strongly supported by better availability of key components whilst the higher interest rates have caused some destocking amongst Electric Vehicles and Consumer Electricals customers.

Volex said it is optimistic about a number of potential near-term sales opportunities to make further progress in the second half of the year, and remains on track to deliver full year results in line with market expectations. Murat has meant mid teens eps enhancement this year and with net debt/ebitda of 1.3x, there is also scope for other deals.

With Murat included for seven months, Peel Hunt forecasts eps of 32.5 cents for the year to end March, lifting to 38.4 cents next year, for a prospective PE of 8.9. *Buy.*

Reach (RCH) 74.75p

Sector: AIM, Media

Reach's Q3 trading update for the 3-month period to end September reiterated its confidence in meeting expectations for the full year (pretax profit of £92.7m; eps 22.4p) helped by plans to reduce full year operating costs by 5-6% during H2.

There has been a slight improvement over H1's declines of Digital when they were down 16.1% with Print down 2.7%. And there has been continuing strength in data driven revenue (higher margin), which continues to be robust and now makes up a larger part of digital revenues at 42% - and we're less than 8 months away from the removal of third party cookies from Google Chrome, which has huge positive implications for online publishers like Reach (see page 6 also).

Reach has also finally concluded both the 2019 and 2022 triennial valuations of its pension with a modest increase of £5m and the deficit will be removed by January 2028. With cost cuts and low H2 comps, it looks like we have passed the nadir in its fortunes. *Buy.*

Restaurant Group (RTN) 67.5p

Sector: Travel & Leisure

Restaurant Group has agreed an all cash bid from Rock Bidco (owned by Apollo Funds). The offer of 65p per share values RTN ordinary shares at c.£506m with an enterprise value of £701m. The acquisition price represents a 34% premium to the share price the night before and values the business on 6.8x FY24E EV/EBITDA on Jefferies' estimates. Activist investors Oasis (17.8%) and Irenic Capital (1.9%) have voted in favour of the acquisition, which requires approval of 75% of the shareholders.

But this isn't the only bidder in town. A few days later, Restaurant Group revealed that an approach for the business has been made by Wheel Topco, the owner of PizzaExpress, which could signal a bidding war.

The price has risen over Apollo's 65p offer; await developments.

Solid State (SOLI) 1090p

Sector: AIM, Electrical Equipment

At the AGM, SOLI reported it has made a good start to the year with strong growth in the security & defence sector and good growth opportunities in medical. The Custom Power acquisition is bedding-in well and enhancing growth, with US/UK collaboration driving forward integration gains and product opportunities. *Keep buying.*

ME Group (MEGP) 141p

Sector: Leisure Goods

ME's H1 to end April shows sales growth of 25% to £144m with pretax profit up 37% to £27m and earnings per share of 5.3p.

Despite a flat number of units in operation within Photo.ME (the largest division at 58% of sales), divisional revenues climbed 25% to £84m and EBITDA by 26% to £30m (35% margin). This was driven by a climb in the ARPU per machine (+27% to £6,152) through a combination of price increases and higher activity levels across core European markets while activity levels in Japan and China also continued to recover after pandemic related restrictions. The group is planning to rollout 1,000 of its next generation machines this year climbing to 3,000 next year.

Since the period end, ME has paid £5.5m for FujiFilm's automated photobooth business in Japan, with the deal expected to add £2.2m of pretax profit in FY24.

But rapidly ballooning in size is the Wash.ME division, which grew sales by 37% to £38m from both an increase in the number of *Revolution* laundry units in operation and also higher consumer demand. Wash.ME is rolling out Revolution laundry machines at the rate of 50-60 machines per month down from 80-90 last year but only because of supply chain constraints. ARPU climbed 18% to £15,266. EBITDA in the Wash.ME segment grew by 39% to £18m (slightly lower margin but still 48%).

Despite the fast rollout of laundry machines, net cash at 30 April stood at £24m.

Overall, ME is looking well on track to hit Canaccord's forecast of £64m pretax profit/eps of 13.1p for the year just ended. *Tipped at 67p in January '22; Buy.*

Frontier Developments (FDEV) 250.5p

Sector: AIM, Leisure

Outer year eps upgrades after the update this month.

Ahead of entering its important November and December trading period, which will include the long awaited release of *Warhammer Age of Sigmar: Realms of Ruin* on 17 November, FDEV said it remains comfortable with FY24 market expectations (consensus revenue £108m and EBITDA loss of £9m).

Like many video games companies, FDEV inflated its expense bases during 2020 and 2021 when millions of us had turned to game playing whilst at home - its average staff count rose 69% to 839 in FY23 from 496 in FY20 - and this had reduced focus on return on investment. FDEV has therefore now announced an Organisational Review.

It plans to reduce annual operating costs by up to 20% by slimming down its employee base (via a recruitment freeze, spending cuts, redundancies). It says this won't impact its ability to deliver on revenues and growth capacity in part because headcount had previously grown to support the Frontier Foundry venture, which is now closed. The resulting actions are expected to conclude by early 2024 leading broker Zeus to forecast "a recovery in adjusted EBIT margins to 5.3% in FY25 and 9.4% in FY26." The broker reduces cash expenses by 20% in FY25 compared to prior estimates and is therefore increasing its FY25 forecast from a £0.5m EBIT loss to a £6.3m profit, whilst the following year goes from £3.8m profit to £11.9m. *Buy.*

Shoe Zone (SHOE) 212.5p

Sector: AIM, Retailers

Having seen its eps forecasts upgraded in both June and July, Shoe Zone has said FY23 will now beat even those upgraded expectations. Pretax profit is expected to be no less than £16m, which is 20% of the previous expectation.

FY23 sales to end September were +6.1% to £165.7m and only £2m better than expectations but the improved performance has come from strong demand through the key 'Back to School' period as well as an increase in gross margin (+80bps to 62.1%) attributed to lower freight container rates and improved stock management.

Store revenue was £135m, +3.9% in the year, despite closures leaving 37 fewer stores (323) as Shoe Zone continued its march towards bigger and fewer stores, which gives rise to improved productivity, and increased product range and customer choice through introducing third party brands. Digital sales also accelerated going into H2 and contributed 18.7% of sales.

Zeus has upgraded FY23 eps by 20% to 26.1p with the current year's forecast rising by 26% to 24.7p. Net cash at the period end was £16.4m or 35p a share despite paying £8.2m in dividends and £6.4m in share buybacks. *Tipped at 67p in March '21, the gain to date is 217%. After the near vertical climb, I wouldn't stop you taking a part profit at this juncture if you wanted to.*

THG (THG) 63p

Sector: Personal Care

THG has registered an improving top-line trend with Q3 revenue reaching -2.1% versus -8.1% in Q1 and -6.9% in Q2. Better than that, performance improved each month in the quarter and September went back into positive territory at +3.2%.

Beauty revenues declined by 4.4% YOY to £272m but has seen a marked improvement through the period, culminating in a September constant currency exit rate of +5.1%. The impact of global de-stocking in the Beauty manufacturing business has eased, supporting a return to growth for THG Beauty in September (+5.1% constant currency).

Nutrition has reported a record Q3 EBITDA performance. Sales growth declined 2.3% in constant currency to £156.2m but with margins bouncing back sharply as whey prices recede, a strong year looks in sight.

At THG Ingenuity, the H1 revenue decline of -14.9% improved to -8.4% through Q3, and -2.3% in September. Completion of the three-year global infrastructure roll-out means FY24 capex spend will be c.£30m less than previously guided at £100m-110m (FY 2023 guidance c.£135m). Q4 is the peak quarter for most of Ingenuity's clients and generates the maximum GMV-linked revenue for the division, which should further support margin. Free cash generation is expected to reach breakeven in FY23.

One broker reckons that on a sum of the parts basis, Nutrition is worth £1.8bn (2.5x sales), Beauty £1.3bn (1.0x sales) and Ingenuity £0.34bn (2.0x sales). To unlock the valuation, a US listing of the Nutrition side is rumoured. *Await developments.*

LBG Media (LBG) 89.5p

Sector: AIM, Media

LadBible, the company born out of a sexist Facebook page, and which under chief executive Alexander Solomou has since become one of the biggest global publishers on social media, has this month announced its first acquisition since the IPO.

It is buying Betches Media, a group of US-based digital media content production and publication businesses, which brings in 10 female-focused news brands, a US presence, and introduces new capabilities, including Podcasting. The brands have an established audience of 32m, of which 25m are US based (86% of the audience is female).

Betches has a strong growth track record and in FY22 had sales of US$14.6m (£11.8m) and EBITDA of US$3.9m (£3.2m) at a margin of 27%. LBG Media is buying the business from its three founding partners for US$24m paid on completion and a four year earnout of US$30m - making it hugely eps enhancing from day one. The deal leaves LBG with net cash of £20.1m for other deals. *Buy.*

OntheMarket (OTMP) Bid: 110p

Sector: AIM, Real Estate

OnTheMarket has announced a recommended cash offer from New York property giant CoStar Group, which already owns Homes.com (#2 residential property platform in the US), LoopNet.com (#1 commercial property marketplace in US) and Apartments.com (#1 apartment marketing site in the US). The offer at 110p values the business at £99m, a 56% premium on the previous day's closing price.

CoStar is a New York listed heavyweight with a market cap of over US$33bn and has the stated ambition to displace Rightmove with OnTheMarket, which is why both Rightmove and Zoopla fell on the news. CoStar already has irrevocable commitments from shareholders representing 29.51% of equity. *Tipped at 87.5p in May '22; accept the offer.*

GB Group (GBG) 230p

Sector: Aim, S'ware & Computer Services

GB's H1 24 trading statement shows the first shoots of recovery with monthly transaction volumes in Identity stabilising.

Overall, constant currency growth was 2% at £132.4m and excluding crypto, which was the proforma base used in FY23, growth was 3.3%. Year-on-year, opex costs are down c.£6m with savings coming from integration/simplification. Operating profit was impacted by FX hedging distortions and before FX, profits grew from £21.9m to £23.4m, helped by cost efficiency measures. Based on forecast eps of 15.5p, the PE is 14.8 and GB could easily attract a predator at double the price. Results are due 28 November. *Buy.*

Supreme (SUP) 103.5p

Sector: Personal Care, Drug & Grocery Stores

Supreme has preannounced its H1 to end September, which will be a record, with "revenues up by over 55% to £100m and EBITDA of no less than £15m." The Elf distribution agreement has contributed c.50% of the growth with the other 50% coming from growth in all four business categories.

At the same time, Supreme has announced some Vaping sale safety measures designed to "ensure its owned brands do not create any interest from underage vapers" including to discontinue production of brightly-coloured disposable vapes, make packaging plain and remove flavour branding, which promotes analogies with confectionary.

On current year forecast eps of 15.3p, the shares trade on a PE of 6.8. *Buy the dip.*

Kooth (KOO) 300p

Sector: AIM, Software & Computing

Kooth's interims are largely of academic interest given that Kooth signed the transformational US$188m+ California contract in July. The keynote is that the US platform has already been built and a beta version has soft launched in two California counties. It is on track for the full launch of its App and support infrastructure in January.

H1 22 revenue grew 29% to £11.7m and EBITDA was flat as expected due to the ramp up in costs to support the US launch. Annualised recurring revenue (ARR) grew 16% over the prior year to £21.4m.

UK revenues increased 9% to £9.8m with new contract wins in CYP and 52% of contracts being expanded on renewal, offset by increased churn, particularly in UK Adult where some pilot contracts were not renewed in the face of acute funding pressures in the NHS. The demand backdrop remains strong with a 16% annual increase of people in contact with mental health services. Kooth's system also delivers a £3 return for every £1 spent on Kooth services at a time when the ICSs are mandated to deliver 6% cost efficiency savings in 2023/24.

In the US, Kooth has stepped-up recruitment and investment in products in H1 in preparation for the California launch with software investment rising from £1.3m to £3.5m, resulting in a net cash outflow of £2.6m and a final cash position of £5.6m. The £10m equity raise post period will allow it to continue to invest. Feedback from the beta version of the App launched in two counties (servicing

~250k students) will be used to iterate further development and improvements over the next few months. The smaller Pennsylvania pilot contract has now reached almost 100k students across 30 school districts, with uptake ahead of expectations. A possible expansion of the pilot may come as soon as Q4.

Whilst some challenges persist in the UK market due to NHS funding constraints, management have reiterated it expects to generate >£34m revenues for the full year helped by the California contract go-live in Jan '24 when revenues will ramp up in earnest. *The shares are worth buying on quiet days*.

Wilmington (WIL) 336p

Sector: Media

Wilmington's full year results shows net cash has ballooned from £20.5m to £42.2m - worth 48p a share. Sales were +9% to £122.1m (organic +7%) but reflecting the efficiencies of the digital first platform, which was launched and improved, pretax profit was +30% to £24.1m. Eps were +27% to 21.3p and the dividend climbs +22% to 10p.

As CEO Mark Milner notes, since the strategic review, Wilmington has delivered two years of quarter-on-quarter profits growth, despite the 'challenging' macro-economic backdrop - helped by the fact that Wilmington sells must-have information as opposed to relying on advertising, and its tight focus centres on large, growing and rapidly evolving Governance, Risk and Compliance requirements. Annual recurring revenues are now 39% (2022: 37%) of Group revenues.

The Intelligence brands, which deliver specialist data and analytics that give customers the detailed insight they need to understand the regulatory landscape, reported 3% organic growth to £57.2m, with strong performance from the Axco, Pendragon and APM businesses offset by a decline in the healthcare business, which supplies information on practitioners, facilities and treatments in the UK and French health sector. But even so divisional margin soared from 19% to 23%. Training & Education delivers specialist training that equips them to navigate it successfully through subscription products and training (eg. its biggest brand is the International Compliance Association for the financial services sector) and achieved a particularly impressive 15% growth in organic revenue to £64.9m, at a 25% operating margin.

Forecast for the current year is £26.5m pretax profit/eps 22.1p but with cash piling up, an acquisition looks set to arrive before long. *Buy*.

UPDATES & IDEAS

Below, I look at shares in two companies that have had a tough couple of years but are now clearly past the worst. The timing could be excellent for some profitable investments.

• First on my list is a recruiter, **Gattaca** (GATC; 108p), which specialises in placing technical and engineering staff mainly on contract or as permanent workers. GATC's business is characterised by long-term agreements to supply staff who have hard-to-find engineering skills and it is one of the market leaders in placing candidates into science, technology, engineering and maths (STEM) careers. The key industries are aerospace, defence, highways, water, rail and infrastructure (civil engineers, architects, electrical engineers) - so the airport expansion, HS2 and rail electrification as well as technology advancements in cyber security, IoT, the Cloud and 5G, have been keeping the tech experts it supplies busy.

The business has not been too closely followed by the City in recent times and the shares are tightly held with founder George Materna, who owns 25.5% and Morson Group (22.2%). With Materna due to stand down at the next AGM, I think it's increasingly likely that he will sell his stake to Morson as a prelude to a bid.

As chief executive Matthew Wragg, who I met during the month explains, the last four years have been overshadowed by fixing an acquisition that went wrong. The culprit, Networkers International, had focused too heavily on supplying temporary and permanent staff to mobile network operators. But as that business tailed away, profits turned to losses and having paid £57.9m, Gattaca has had to write off most of it and closed almost all of the international offices that came with it in Latin America, Middle East and Asia. Further problems came from a US Department of Justice enquiry over Networkers supplying staff to a company with links to Chinese telco Huwai for projects in Iran between 2010-16, a period prior to its acquisition.

But now after years of retrenching, on a continuing basis, revenues in the latest year were down to £385.2m (from 2022's restated £403.9m). Gattaca generated Net Fee Income (NFI) - the gross profit on temporary contractors and permanent placements - of £43.4m with contract NFI (74% of the mix) up 2% year-on-year and permanent down 11% (26% of the mix), reflecting the broader market environment. Now, 95% of the Group's NFI comes from the UK with international down to 5% (Madrid, Capetown, US and Canada).

What has recently hampered the business is not just the scarcity of the skilled candidates it places out but there has also been too-high-an-acceptable level of attrition amongst its senior sales staff, most of whom are "360 degree recruitment consultants" handling the entire recruitment process from candidate sourcing to managing the client requirement.

Last year a third of them left and having bottomed at 4,000, there are now 4,300, many of whom are less experienced and can't handle as many accounts. This had the effect of pegging down a key metric of efficiency - the conversion of NFI to profit - in other words how much of the mark-up on contractors and permanent placements falls to the bottom line. Conversion has fallen from 17% in FY18 to only 5.4% in FY23. But as salesmen become more experienced with the task in hand, it will climb back, says Wragg.

I think its days of independence are numbered. The group's net-debt level was something that historically concerned investors because clients tend to pay recruitment firms after the firms themselves pay the staff they place. But this is a thing of the past as Gattaca has moved from £30m of debt to a net £21m cash position (versus its £36m market cap.) by ditching low paying and slow paying clients and unlocking working capital. Debtor days have also improved by 8 to under 47 last year. Based on forecasts of £3m pretax profit/eps 6.8p for the current year and £5m/11.3p next, the shares are looking cheap when you strip the cash out. With a full year dividend of 5p per share, I think Morson will step in before recovery becomes evident. *I am a buyer.*

• Another where a would-be-predator has picked up a sizeable stake in a cash rich business is **Topps Tiles** (TPT; 46.5p), with MS Galleon, chaired by Polish billionaire industrialist Michał Sołowow, acquiring 29.9% and there have been some punchy upgrades in the past couple of years. Earlier this year MS Galleon requisitioned an EGM to oust the chairman and appoint two of its nominees to the board. Galleon also owns Cersanit, a major European producer of tiles, and has tried using its holding to strong arm Topps to purchase a third of its tiles from Cersanit. But other shareholders accounting for 39% of the shares disagreed and so MS Galleon scuttled away with its tail between its legs.

Topps was established in 1984 and floated on the Full List in 1997. Topps operates 304 retail stores and has been 'right sizing' to a target of 300 stores, down from 372 at the end of 2017. At the heart of Topps' DNA is the fact that it stocks 400 SKUs and 87% of its tile range is own brand or exclusive while it regularly refreshes its products and last year introduced 32 new ranges. As a result, it is now market leader with a 19% share of the c. £700m sector. As well as retail, Topps leveraged its buying power and entered the commercial sector via two acquisitions in 2017 to target tiles in hotels, health & fitness centres and supermarkets, and also launched a new online pureplay tile retailer, Tile Warehouse.

When interest rates rose, and the housing market slowed, you would have expected Topps' sales to have stagnated, in common with other bigger-ticket home-related retailers. The company's large store footprint and, therefore, large fixed-cost base, should have meant Topps' high operating leverage would work against it. But not so; the online side is on such a fast growth trajectory, with sales up 40%+ in Q4 (13 weeks to 30 September), that FY23 is, in fact, going to be its third consecutive year of record sales with sales expected to be £263m, up 6.4% year-on-year and £40m higher than FY19.

Commercial has also moved into profits in Q4 after a reduction in operating costs and there is a significant market share opportunity. Gross margins group wide have increased sequentially through each quarter of FY23 as freight and product cost inflation has eased.

Topps reports on 28 November and management has reiterated guidance, with Peel Hunt forecasting a pretax profit of £9.8m/eps 4.6p, lifting to £13.7m/5.6p this year. Forecast year-end net cash of c.£25m and a 3.8p dividend (7.5% dividend yield) only adds to the attractions.

FUTURE (FUTR)

Sector :	Media	
Latest Price :	843p	
High/Low :	1754p - 632p	
Market Cap. :	£999.8m	
Shares in issue:	118.6m	
end9/2023 EPS/PER est	141.0p	6.0
end9/2024 EPS/PER est	149.4p	5.6
end9/2025 EPS/PER est	163.6p	5.2
Contact	01225 442244	
Registrars	03707 020003	
CALENDAR		
Int/Fins/AGM	MAY/NOV/FEB	

Signs are mounting that a long, dull period is over for former glamour stock Future. Between 2017-2021, Future caught the imagination spectacularly. The price went from 352p when I first wrote on them in December '17 to a post TMT bubble high of £39 by August 21, a gain of over 1000%, raising the price-earnings ratio to more than 50 as investors discounted years of fast growth to come.

Chief executive Zillah Byng-Thorne, the architect of this growth, had taken office as CEO three years earlier. At the time, Future was a dead tree publisher of paper magazines where circulations were in decline but her great insight was to recognise that these paper magazines all had an authoritative and engaging voice and she could use the content to build large and fast growing specialist websites (without the burden of creating this content from scratch). She was able to monetise this content through digital advertising, live events and increasingly via retailers with commission generated from e-commerce.

She then made a number of acquisitions in the UK and the US, many of which may not be known to UK investors but its portfolio includes the #1 consumer technology titles in both the UK and the US, #6 beauty and fashion title in the US, #4 in the UK, and the #1 Homes title in the UK; eventually she also bought GoCompare, the insurance comparison website.

Since then, like a lot of companies, Future's price has fallen sharply to just 843p due to various macro environmental factors such as falling ad spend and weak consumer confidence, which has reduced e-commerce volumes. Further investor concerns have stemmed from declining online audience numbers for both FY22 and the first half.

H2 shows the worm is turning

But when the company issued an update on 29 September, Future said audience numbers in the second-half had stabilized and it had seen positive month-on-month momentum in the final quarter. GoCompare has also benefited from more cost conscious consumers wanting to switch insurers. Based on eps forecasts of 141p for the year just ended and 149p this year, the PE drops to 5.6. I think the shares are close to the nadir and so I've decided to set the hook early and buy the shares ahead of results on 7 December.

History

Established in 1985 as a single magazine, the company has had three distinct phases. The first phase began when the company was built up during the heyday of the computer gaming boom in the nineties. Its claim to fame was that it had the rights to publish under licence both the official magazine for Sony's Playstation 2 and Microsoft's X-box consoles and it went public with great fanfare in June 1999.

But the shares subsequently spectacularly crashed and burned, and by the time ZBT arrived in 2014, initially as finance director before becoming chief executive, the business spanned a variety of areas such as consumer technology, gaming, photography, music, movies, design and country sports but the company had been grappling with a bloated cost base and loss-making US operations.

The second phase then began. ZBT's first move to stabilise the ship was a sharp reduction in headcount, with the sale of Future's sport and craft titles for £24m, strengthening the balance sheet. The paper magazines provided both the content and the cash flow to launch a number of specialist websites, which were then leveraged through ecommerce sales and digital advertising.

Ecommerce and digital advertising

A key "prop" to its success was its proprietary technology. All of the group's websites also underwent a process of being moved to a unified content management system, which has generated big software savings.

There is rarely a paywall in front of Future's websites (ie. they are free to read); instead, Future's main revenue stream is digital advertising, which is c.30% of group income and once again, technology plays its part. Future has developed all the stuff it needs for positioning content on search engines (optimising natural search, which is free traffic rather than necessitating the purchase of keywords) and to achieve better click through rates in order to optimise advertising income from its targeted, niche demographics.

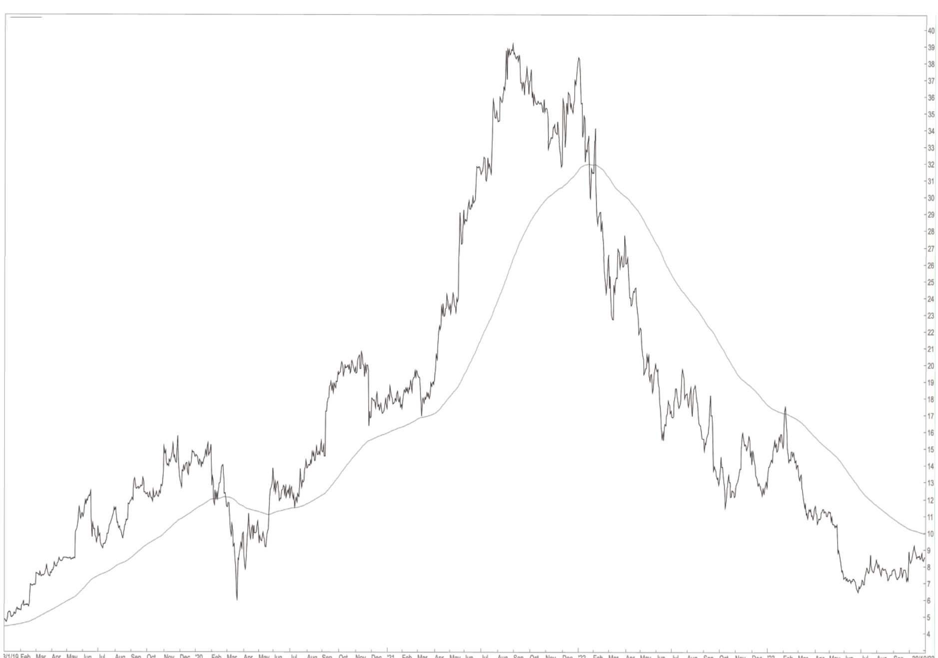
Future has also built a proprietary e-commerce platform called Hawk that links through from the branded websites and this looks at a given published article and will then serve up relevant products based on an algorithm.

For instance, Future's consumer brands, such as *TechRadar* and *PCGamer* are typically very close to the point of purchase as people investigate their options. The website for PCGamer, for instance, might have a buying guide on a graphics card or peripheral device and at the bottom of the page, Future's technology will serve up a set of links to retailers' websites where you can buy them from. Future then earns commissions on transactions based on the retail value of the product and even better, it earns a percentage of the total basket, so if a customer is looking at a graphic card on John Lewis' website but instead buys a sofa, Future still earns. The technology runs at scale with literally tens of millions of product offerings per day and is engaged with c.2,600 merchants. Overall, ecommerce income accounts for a further 30% of total group sales.

Acquisitions

Having built all this stuff, Phase 2 also saw Future embark on a number of acquisitions. To many it might appear counterintuitive to say that if print circulation is in decline, you address the problem by buying more print titles but as acquisitions arrived, they instantly benefited from leveraging the same technology platform.

Future was able to move newly acquired titles to its existing platform, cut out much of the top management and deliver buying synergies; for example, a greater share of newsstand gives them greater negotiating power with magazine distributors. A good example of this was the purchase of *TI Media* in April 2020 for £140m. This was a UK print-led consumer magazine and digital publisher spanning complementary verticals including Wine, Golf, Equestrian, Gardening and Women's Lifestyle. It had £202m revenue / £29m EBITDA in



the year to end May 2019 but within just 18 months of the deal completing, Future was able to extract £20m of synergies.

In FY22, total sales were £825m, split between Magazines £290m (-2% organically but +58% including acquisitions) and Media £535m. Adjusted operating profit was up 39% to £271m of which a third was driven by this "Platform Effect."

Global platform for specialist media

These days Future is a self-described "global platform for specialist media," split more or less evenly between the UK and US, offering print and digital content across four special interest verticals:

- Games, Entertainment and Tech;
- Lifestyle Knowledge and News;
- B2B (eg. Broadcasting & Cable; Installation, Smartbrief, Prosound)
- Wealth & Savings.

Overall, there are c.220 brands, which attract millions of consumers to their websites, magazines, events and social spaces, and Future monetises these in three ways: Advertising, Direct-to-consumer and Affiliate revenues. At present, the top 11 titles by audience are *Techradar, Tom's Guide, Games Radar, Cinema Blend, Live Science, PC Gamer, Space.com, MarieClaire.com. iMore, Windows Central* and *WhoWhatWear*, with a combined audience of 307m.

Third phase starting now

The third phase is about to begin. ZBT has been replaced by Jon Steinberg. Net debt is being paid down at a rate of knots and was £391m (1.4x net debt/EBITDA), down £25m on six months earlier. Although Steinberg, a former executive with Altice, Dailymail.com North America and Buzzfeed, has yet to unveil what the M&A strategy will look like going forward, investors can start to look forward to a recovery.

The reason I think this way is that Technology is Future's most impacted vertical. Techradar, for instance, Future's largest brand, was down significantly, -26% (-c.11.1m visitors) year-on-year. Some of the audience decline can be attributed to "limited new technology products being launched" and also because most people had brought forward their product purchases during the pandemic. Alongside that the cost of living has also reduced ecommerce volumes (eg. management highlighted that outside of peak periods, such as Black Friday and Amazon Prime Day, average basket size was down c10%).

As tech turns (potentially as soon as Q4 given soft Black Friday/ Christmas trading comps), there is potential for growth to recover sharply.

Removal of Cookies increases value per ad

A second reason for being positive on prospects is diversification and premiumisation - even as online audience numbers fell 19% year-on-year in the latest H1, Future has proven adept at protecting yields via increased direct campaigns, which have risen, whilst emerging verticals are seeing growth (e.g. Women's Lifestyle).

What is also likely to boost short run prospects is the removal of third-party cookies from Google Chrome by H2 24 to create a more private web.

Advertisers presently use such cookies to build up online profiles with this data, which may consist of a user's demographic characteristics, likes, dislikes etc to develop extremely effective targeted ads, which often achieve higher rates of conversion.

Google is offering a new targeting feature, 'Topics' but this doesn't allow accurate profiling and given interest-based ads tend to perform so well, I think this will increase demand for publisher inventory, increasing the demand for contextual digital Ad space with publishers utilising first-party data - and Future's deep engagement with audiences and unique content proposition means it should be able to drive more value per ad.

Future has already developed an advanced first-party data platform solution, Aperture, to collate and harness user data, across its whole array of specialist topics and will be able to offer premium targeting. Given that this is the largest browser to pull the plug on cookies (represents 85% of search) it could drive ad sales up quite sharply. Don't forget direct advertising deals can often lead to 10x returns per impression versus open market pricing.

What people don't appreciate is just how diversified the business has become and what an amazing amount of advertising inventory the group holds. Many of the sub-verticals it serves are very large and international. Three are worth highlighting. Wealth is considered the standout in terms of audience and monetisation growth potential. In 2021, Future entered the space by the £300m purchase of Dennis, which brought the brands, *Kiplinger* and *Money Week* and subsequently added *Decanter*. Kiplinger is a well-known US financial advice brand and the largest brand making up c.80% of the sub-vertical. Also exciting are the sub-brands within the Lifestyle space including womens lifestyle magazines *Marie Claire, Women & Home* and *Whowhatwear* where its content reaches something like 1 in 3 women in the US.

Finally, there's GoCompare (25% of group), which was bought in 2021 for £594m. This is a leading player in the price comparison and consumer saving space through its *GoCompare, WeFlip, Look After My Bills and MyVoucherCodes* brands and has recently found its second wind as consumers shop around for better deals.

All this for a prospective PE of 5.6 looks compelling. *I am a buyer ahead of results on 7 December.*

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lockers and Wifi. Its PricePoint system re-calculates pricing based on demand every two minutes. The latest average bed rate stands at £23.44 (+9% from £21.50 last year). After the pandemic-induced lows, the number of beds sold grew 41% to 403k giving it an occupancy rate of 68.5%, although much of the drop through to profit was masked by higher wage and energy costs.

Most customers book through Online Travel Agents (OTAs), such as Booking.com, Expedia or Hostelworld, so Safestay needs to spend relatively little on marketing. But the downside is the reduced margin as there is typically a 15-18% commission to pay the OTA so increasingly it has begun to sell its bed stock direct on its revamped website and has also established a central office in Warsaw to target group bookings from schools and universities. The beautiful aspect of such group business is that not only are such bookings higher margin but by nature, they are usually made at least three months in advance and there is a high chance next year's class will also do the trip. Group bookings are again climbing post the pandemic and is c.13% of sales whilst direct is 10%, with OTA the remainder.

Interestingly, Lipman also talks of an increasing trend in customers booking longer in advance; the last two years had seen the time between booking and travelling come down as no one was sure they would be able to travel. Business on the books is £1m higher than this time last year.

Lipman made his first foray onto the Continent in 2017 and since then he has put its flag down in 11 different cities. Obviously this spread limits synergies so his plan now is to concentrate on present countries, as he fills out the portfolio to a mid term target of 40 units.

Its present site count makes Safestay No.7 in the European market but growth to date hasn't all been plain sailing. Covid obviously caused a hiatus when travel was restricted and Lipman was forced to sell one of the crown jewels, a 615 bed site in Edinburgh, to the biggest rival, A&O, for £16m just to stay afloat. Since then it has been retrenching but now it looks ready to go again. Earlier this month it returned to Edinburgh by paying £4.3m for a development site. Now an office, which had previously been a hotel, three floors of the site are expected to have been covered by March next year to add 225 beds.

Safestay will also often expand and improve existing sites where demand is high. For instance, its flagship site in Elephant & Castle has undergone a £2.4m investment for a 73 bed extension and full bar renovation. Such enhancements to freehold valuations (eg. Elephant & Castle was last valued at £26.8m), alongside banking facility headroom and equity issues, provides cash for further expansion. Meanwhile, cash at bank stands at £7.3m, with bank borrowings of £16.6m (£12.7m of which is at a rate of 2.95% plus SONIA).

Underlying net asset value stands at 41.6p per share, although the recent interest rate increases and yield expansion may crimp this when it next reports. For the current year to end December, sales are forecast at £21m with a breakeven result, lifting to £0.5m pretax profit (£7m ebitda) next year so it's clearly at an inflexion point. Last year it received an unsolicited bid approach from an unnamed party, which was subsequently rejected by shareholders who include Hong Kong's "Iron Lady" Anson Chan (23%), Soros Fund Management (19%) and Janus (10%). These large holders make for a narrow market at times. *One to watch.*

UPDATES & IDEAS

• Travel is on the rise once more - and an army of blood sucking bedbugs are keen to travel as much as humans, invading the whole of Europe, with Rentokil reporting a 65% surge in sightings across homes, cinemas, trains and hospitals from 2022 to 2023. But Larry Lipman, chief executive of **Safestay** (SSTY; 24.2p), which runs boutique hostels across Europe and the UK, was in good cheer when I caught up with him over the month.

The last time I met Lipman was back in 2015 when I visited one of his newly opened hostels in Holland Park and since that time it has been expanding and is now trading from 14, together with one development site (Edinburgh) and two hotels (Vienna and Berlin).

Lipman is a property man. He previously built up a number of listed businesses including Safestore, Hercules Property Services, Bizspace and Safeland. Safestay was established in 2014 and floated the same year.

At the time, it had just one hostel and a plan to consolidate the highly fragmented European hostel market, which is growing at 5% a year and is already worth >US$6bn. Much of the hostel market is held by independents and Lipman has been expanding by buying existing hostels, either individually or small groups (nine of the existing came this way), buying hotels which it is able to convert and also by occasionally taking on development sites. The existing portfolio consists of five freeholds, three held under finance lease and the rest leaseholds, with bed numbers overall standing at 3,251.

The location of Safestay's hostels is the key to success. The hostels are located in the prime central areas in main tourist cities with immediate proximity to travel hubs and restaurants, activities, shops, tourist attractions, etc which allows it to achieve high occupancy.

Hostels have on average c.240 beds or c.200 units. A unit is either an individual bed in a shared dormitory or is a private room (made up of 2-4 bunks) sold as a whole. Contrary to what most of us also might imagine, Safestay hostels are not solely aimed at 18-30 year old backpackers, although this is its prime audience, but is also often used by school and university groups, large family groups as well as business users.

To target a bigger audience, unlike most operators, Safestay has what Lipman refers to as a "boutique standard," with high quality furnishings and hotel-style services including a 24-hour reception space, licensed bars and restaurants. All rooms are fully equipped with free bed linen, secure

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THE GROWTH PORTFOLIO 3

PERFORMANCE TABLE		Change on One Month	Since Start
Growth Portfolio		-8.71%	+263.81%
FTSE-100	7291.28	-4.16%	+11.35%
FTSE-All Share	3933.17	-4.70%	+11.61%

A bruising month. The febrile situation in the Middle East has distracted everyone from things closer to home. Inflation figures this month were flat but for the first time I can agree with the Bank of England governor that we are about to see a plunge in October's figures. Most commentators say rates have peaked, which should provide much needed relief to retail sales and construction output - I am expecting interest rate cuts in the first half of 2024 before damage to confidence becomes too great. Labour also overturned large majorities in two parliamentary elections, in a stinging blow to Prime Minister Rishi Sunak, paving the way for tax cuts ahead of the election next summer. All this should have encouraged a growth mindset but nothing seems to break the mood.

Undervaluations are glaring. If inflation does tick down, it would increase confidence and drive strong Black Friday/Christmas trading against a soft comp last year. One I think could double quickly is Future, which GP3 already holds and based on an eps forecast this year of 149.4p, the PE is 5.6. Future attracts an audience of c.307m across a broad range of verticals and brands, and this includes something like c.40% and c.30% of people online in the UK and US, respectively. Its key brand, GoCompare.com, is absolutely humming as the average cost of a comprehensive car insurance policy is now £924 - an increase of £338 over last year! Results are on 7 December.

I also include Tristel, a new one, which has just had its CIO2 disinfectant approved by the US regulator, a market that is 10x bigger than the UK. Not cheap but its gross margins are high at 81% and with the US being tackled through a third party distributor/royalty model, it could start to 'beat' expectations. Elsewhere I highlight Topps Tiles and Gattaca as prime bid candidates.

		Shares Bought	Date Bought	Buying Price (p)	Total Cost (£)	Present Price (p)	Value Now (£)
1000	^*	Softcat	7/12/15	229.2	2337	1239	12390
10000	*	SDI Group	15/2/17	20.5	2095	88	8800
1000	*	Alpha Group	27/7/17	470	4745	1590	15900
1000	#*	Future	9/4/18	329.5	3340	843	8430
15000	*	UP Global Sourcing	31/1/19	59.9	9075	114	17100
25500	*	Luceco	31/1/19	90	22837	110	28050
60000	•	XLMedia	8/7/19	43.7	26330	7.25	4350
2500	*	Ergomed	22/10/19	313	7870	1342	33550
10000		Volex	9/12/19	133	13345	282.5	28250
10000	•	Mpac	3/2/20	259	25990	207.5	20750
26069	•∞	Reach	3/2/20	98.8	26019	74.75	19487
18000	•	Superdry	22/9/20	135	24491	37	6660
3000		Victoria	13/11/20	450	13545	331	9930
7000		Supreme	5/3/21	189	13275	103.5	7245
16000	•	On the Beach	5/7/21	199	32065	93.5	14960
25000		Staffline	7/8/21	65.4	16395	26.25	6563
10000		T Clarke	6/9/21	147	14745	122.25	12225
32000	•	Boohoo	24/5/22	66	21410	31	9920
3000		Yu	12/12/22	426	12825	1000	30000
50000		musicMagpie	12/12/22	24.5	12295	20	10000
30000		THG	1/3/23	60	18135	63	18900
3000		Frontier Developments	5/6/23	510	15345	250.5	7515
7000		GB Group	3/7/23	228	16005	230	16100
10000		Dr. Martens	14/8/23	152	15321	115	11500
						Cash £	5233
						Total £	363807

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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