In its twenty-third year
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TMI

“Relative strength is the only growth variable that consistently beats the market”

The Momentum Investor

STOCKMARKET NEWSLETTER

Authoritative Independent Monthly Share Selections using Technical & Fundamental Analysis

This Issue

Playtech — Buy
Gaming software provider trading ahead of expectations; director buys highlight deep value

Easyjet — Buy
Low cost airline’s deep pockets ensure it’s well placed to exploit recovery

Vistry — Buy
Countryside deal to double profits and increase exposure to less cyclical Partnerships

Crest Nicholson — Buy
Dirt cheap on PE of 5.5 and dividend yield over 7%

Shoe Zone — Buy
School shoes chain announces three “beats” in successive months

Energean
Gain to date: 170%

H&T
FY’22-’24 eps forecasts upgraded 18%, 37% and 30% respectively!

Diversified Energy
Announces US$210m acquisition in East Texas

- - -

FTSE-100: 7282
FTSE-All Share: 4000
Small-Cap: 6315

Next issue on Saturday 22 October

Always remember the risks in buying shares. With small companies there is an above average degree of risk compared to buying blue chips. Please be aware that we have not assessed the suitability of any of these investments for you. The newsletter simply states a personal view and diarises the editor’s investment decisions. You should therefore consider this publication as information only and not as a recommendation to engage in investment activity. Please speak to your stockbroker or other qualified individual to ascertain whether any of these companies mentioned would form useful additions to your own portfolios. Past performance is no indication of future success.

Playtech

Sector: Travel & Leisure | Share Price: 455p | Epic Code: PTEC

Key Data

Address:	Upper Church Street, Ground Floor, St George’s Court, Douglas, IM1 1EE, Isle of Man
Telephone:	01624 645954
Shares in issue:	299m
Market Capitalisation:	£1.36bn
Next Results:	Interims: September

With recession on the minds of every investor, I thought it time to look at the performance of “sin stocks.” Sin stocks refer to shares in businesses considered unethical, immoral or unsavoury. Traditionally, it has been applied to alcohol, gaming, tobacco and more recently cannabis growers.

Playtech, the subject of this write-up, owns one of the top software platforms to run gaming websites as well as player account management solutions; it is already benefiting from an explosion in gambling on the internet, which is projected to grow from US$57 billion in 2021 to US$153 billion by 2030. Alongside the proliferation of mobile devices and acceleration in internet speeds, which have increased online spending, the gambling industry has made itself even more attractive through technological innovations such as linking millions of online casino, poker and slots players together to boost liquidity and create mega jackpots.

In July, Playtech said that it was trading ahead of expectations. In the light of that, broker Peel Hunt has already upgraded by more than 10% to eps of 46 cents (40p) for the current year.

Profits rise 850% in 12 years

Founded in 1999, a new era began for Playtech with the arrival of current CEO Mor Weizer, a qualified accountant and former technical consultant at Oracle. Under his watch, revenues and EBITA profits soared from €66m and €44m, respectively, in 2007 to €1,508m and €383m in FY’19 before the pandemic disruption clipped them back. Much of that growth came via acquisitions as management sought to diversify and build market share in regulated markets. Landmark deals included PTTS (a marketing and technology platform) for £204m in 2011; BGT, a provider of software for self-service betting terminals for €138m; and largest of all, the €846m purchase of Snaitech, an Italian betting company focused on gaming machines and retail sports betting shops in June ‘18. Playtech also dipped its toe into financial trading (Finalto) but this business was later seen as a distraction and has just been sold.

Two divisions

Playtech operates from two divisions, which generated the following in FY’21:

- Gaming B2B (€554m sales) 49% EBITDA profit
- Gaming B2C (€584m sales) 51% EBITDA profit

Gaming B2B

Having originally focused on the UK, Playtech has transformed into a global business, serving 150 licensees across over 30 countries. Playtech is unique in that not only does it provide the software to run gaming websites and provide the content to run online casinos, poker, blackjack, slots, sports-books and lottery but it also provides support services. These include CRM and marketing consultancy, payment processing advice and customer services. Casino contributes over 60% sales with sports and services each in the mid teens.

A key attraction is that Playtech has built an impressive omnichannel platform to cater for licensees’ every need. The platform allows gamblers to move seamlessly between different games and channels using a single account, which

We are deeply saddened to hear of the death of Queen Elizabeth II. All of us at The Momentum Investor offer our condolences to the Royal Family.

means they can walk into a shop to place a sports bet on its self service betting terminals, cash it out on their mobile walking home and even open a new bet on their computer the next day. That makes it easier for operators to streamline their offering, drive cross-selling, increase player loyalty and optimise lifetime values.

Product flexibility

Playtech usually charges customers a 10-15% royalty on their sales - so it does well when they do - and contracts are anywhere between three years to over five. Customers are charged the maximum if they wanted the Jackpot liquidity options which pools hundreds of players in a central network plus the latest "bonus" features. As well as offering around 1,000 top of the range slot games on its platform (with an annual €200m R&D budget ensuring plenty of new ones) Playtech also hosts around 6,000 third party games thanks to an alliance with Scientific Games, BGT and Quickspin. The latter is charged a royalty of c. 3% of their sales.

When it started out, Playtech offered a one stop shop contract, which assumed clients were UK-focused and didn't have any real gaming software of their own. However, the business model has been tweaked following an unprecedented wave of gaming mergers in recent years including GVC swallowing up Ladbrokes to become Entain; fantasy sports firm FanDuel acquiring Flutter (owner of Paddy Power) and American hotel and casino group Caesars buying William Hill. This increased the risk of losing contracts and Playtech nearly lost Ladbrokes'' (top three customer) work because it already possessed many of the gaming functions and needed to eliminate duplication. Fortunately, a new deal was agreed with the UK part replaced by Entain's overseas businesses including Germany and Spain alongside new and improved functionality. As a result, revenues from Entain (new Ladbrokes owner) have increased.

Learning from that experience Playtech tweaked its business model, breaking up the original package into smaller components or modules. So, for example, "Player Protect" (where its "Bet Buddy" machine learning analytics identifies and manages at risk gambling behavioural patterns and encourages players to take breaks) but not the UK casino and poker modules.

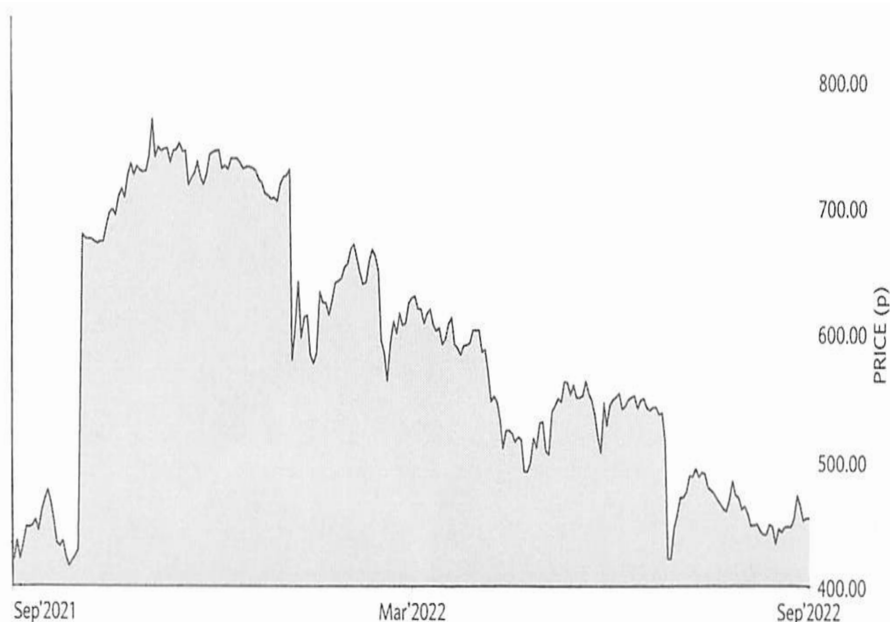
Four key growth opportunities

Playtech has four major growth opportunities that could lift the shares substantially over the next 2-3 years. First, the business is moving away from supplying physical gaming or betting shops to servicing their online equivalents (digital revenues are now c. two thirds EBITDA profit and is rising).

Second, is innovation. Playtech licenses the software to drive gaming websites and concepts in live casino gaming including "Adventures Beyond Wonderland" where punters play online with real croupiers. These feature a revolving studio and augmented reality with dealers dressed as iconic characters taking charge of the "wonderspins wheel" where the numbers are replaced with beloved characters from the famous Alice in Wonderland story such as the doormouse, white rabbit, dodo etc. Each character has a multiplier attached, so if you land on a character with a 4x multiplier, your payout is multiplied by 4. Meanwhile, bonus features include magic dice, which are rolled to determine whether or not you progress from the bottom to the top of a 4x6 board with high multipliers on the top level.

Such innovation has pushed at an open door with demand for Playtech's services, which are provided to gaming operators such as Entain (the former GVC), Flutter, Caesars, Rank, Skybet, Betfred and Bet 365, going through the roof.

Third, while the more mature UK and European markets (72% revenues) provide the majority of divisional B-2-B revenues, a huge opportunity is emerging in the Americas, where turnover rose 67% to €101m (21% revenues). Here, the largest opportunity is in Mexico (sales: €90m), tapping a population of 129 million people, through a joint venture (profit share, equity participation) with Caliente (Caliplay) and Columbia with W Play. There are six joint ventures in all (with attached call options said to be worth €622m - an 81% uplift over H1 '21) and while a planned listing of Caliplay as a SPAC in New York has been postponed due to market conditions, management are working on an alternative independent "vehicle" for it. Playtech additionally operates in Brazil, Panama, Costa Rica, Peru and Guatemala.



Although earlier stage, North America also provides huge growth opportunities for Playtech with 26 States (covering 144 million people or 45% of the population) having green lit sports betting while six allow i-gaming (casino, poker, bingo etc.). The group has licenses in five states and Live Casinos have recently been launched in Michigan and New Jersey, with Pennsylvania and Indiana on the way.

Snaitech growing rapidly

The fourth major opportunity lies in Playtech's B-2-C division (51% group sales), which is dominated by Snaitech, the oldest and largest gaming operator in Italy. This business franchises the right to operate c. 1,600 betting shops and corners (betting terminals in non-betting premises) to individual operators, the majority of which are in Northern Italy. The concessions operate 54,000 amusements with prizes (AWPs) gaming machines and 10,000 video lottery terminals (VLTs), with the latter paying out more in prize money (85% versus 70%).

While the Pandemic hit this business hard, the online business has recovered well with sales up 130% to €230m and EBITDA rising three-fold to €135m between FY'19-'21. With online penetration still low at 27%, analysts expect further strong progress.

Encouragingly, there are now signs that the retail betting and gaming machines sides, where EBITDA has fallen from €117m to €47.3m in the same period, are recovering now that Covid-19 restrictions have been lifted.

Price target 800p

What nicely protects the downside is the prospect of a bid. Since late last year, the company had been in talks with no fewer than three suitors and the shares at one point climbed to 775p although only one, Australia-based Aristocrat Leisure, made a confirmed bid at 680p a share last February. The most recent suitor, TTP, broke it off, blaming "underlying market conditions" but that was before the recent upgrade to profit guidance and disposal of Finalto, which has reduced net debt / EBITDA to just c. 1x FY'22 forecast EBITDA, leaving plenty of firepower for investment.

The shares, hit hard because of the general malaise, now look excellent value trading on a lowly prospective PE of c. 12, versus previous peak PEs of well over 20x.

Peel Hunt's price target is 800p. *I am a buyer.*

Housebuilders look over-sold

The headlines surrounding cost of living increases has seen deep value emerge amongst UK housebuilders but in a recent research note, one broker, Jefferies, says the sector trades at 1x net tangible asset value (NTAV) and below liquidation. It argues share prices now reflect an anticipated 13% decline in house prices. However, there are bright spots amidst the gloom and I highlight two below.

Crest Nicholson (CRST, 231.5p)

Founded in 1963 Crest is unusual in gaining not one, but two public listings over its 59 year history. Originally listing in 1968 as a composite house builder, general contractor and mini conglomerate it nearly went bust in the credit crunch after being taken private in 2007 and loaded up with debt in a joint venture between HBOS and West Coast Capital (owned by entrepreneur Sir Tom Hunter). Second time around (listing again at 220p in February '13) it's focused on housebuilding and has enjoyed a calmer experience with pretax profit increasing from £62.1m in FY'12 to a peak of £207m in FY'17 before Brexit and the Pandemic battered confidence. Originally operating from five regional divisions (but with a generally Southern bias): Eastern, South, South West, London and Chiltern it recently announced plans to add three more in Yorkshire, East Anglia and the North and has opened new offices in Leeds with another shortly following in Bury St Edmonds. This expansion is part of its strategy to expand from 2,407 completions in FY'21 to 3,000 by FY'24 and over 4,200 by FY'26.

Management also set out a plan to improve operating margins back to industry levels, defined as 18-20% over the medium term through redesigning houses, cost discipline and improved land buying. That's already starting to show with H1 '22 results highlighting a rise in margins from 12.3% to 15%, while the order book now covers 96% of expected full year volume. Encouragingly, home completions rose nearly 8% to 1,098.

Management also said they are "past peak uncertainty" surrounding cladding (following the Grenfell tower fire) taking a provision of £105m in H1 for combustible cladding in its high rise developments, leaving £146m of net provision to be utilised over the next 3-5 years. That's well covered by net cash, which rose by £40m to £173m at H1.

With Crest issuing pretax profit guidance for FY'22 of £135m-£140m broker Liberum has lifted eps forecasts 6% to 41.2p (from 34p in '21) dropping the prospective PE to just 5.5 while the dividend yield is a chunky 7.3% (16.5p forecast).The broker says its price to book value of just 0.83x is around a third lower than for the sector while if it achieves its twin targets of 20% operating margins and 4,200 unit completions in FY'26 eps, could be 77p, more than double FY'21 levels.

Liberum adds, "While we await a peak in inflation or interest rate expectations the very depressed sector limits downside. In the six instances since 2005, in which the sector has traded at a forward PE of less than 7.5x, the shares have performed positively in five, with an average increase of 26% over the following 12 months (max: 37%)."

Its price target is 390p. *I am a buyer.*

Vistry (VTY, 748p)

During a market downturn even well run companies get battered along with the also rans and Vistry, whose shares had nearly doubled from 820p in 2018 to a pre-Pandemic high of almost £15 before halving again as the cost of living crisis takes root, falls into that camp. In its heyday in the early 1970s the company, originally known as Bovis homes, was the UK's second largest house builder in the early 1970s but more recently was hit by a scandal surrounding poor workmanship when the previous management, obsessed by housing completion targets, took their eye off the ball. However, the appointment of current CEO Greg Fitzgerald, who cut his teeth building up two housebuilding firms in the 1990s before selling them to (and subsequently joining) Galliford Try, has transformed its fortunes. While at Galliford, Fitzgerald engineered an impressive four-fold rise in the shares after launching a bold rights issue to avail of cheap land during the credit crunch and having acquired a decent grubstake at Vistry, buying an initial £3.22m shares at 920p, he has again achieved impressive results.

In time honoured fashion he restructured the business, initially slowing down completion rates to remove the poor workmanship and also setting out improvement in five key areas: better land buying, price optimisation, a specification review, cost reduction and the roll-out of the group's new housing range, The Phoenix. The result has been a surge in pretax profit from a nadir of £104m in FY'17 and eps of 68p to £188.2m and 111.5p in FY'19. At the same time he also restored Vistry's battered reputation amongst home buyers and restored its HBF customer satisfaction rating to five stars.

Fitzgerald has subsequently moved through the gears with two transformative acquisitions.

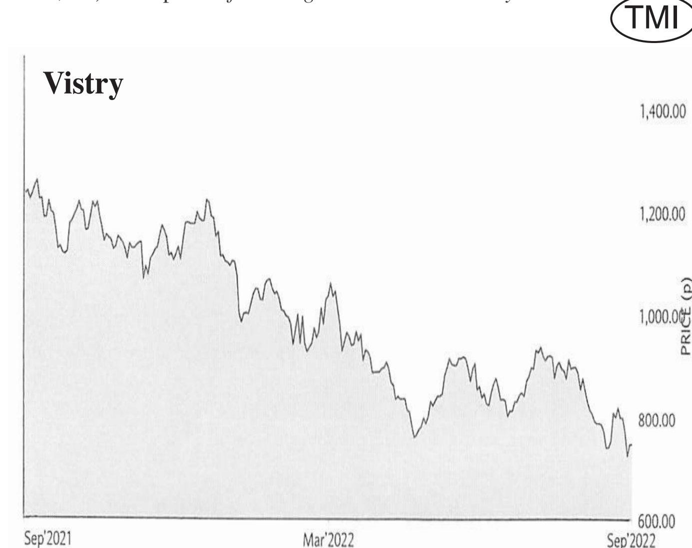
The first was its £1.075bn purchase of the Linden Homes and Partnerships & Regeneration business from his former employer, Galliford Try. Not only did it create a top five house builder with medium term capacity to deliver over 14,000 homes a year but it also added a sparkling jewel in the form of Partnerships, which builds social housing on land owned by local authorities, housing associations and institutional investors.

Vistry works up the designs, gaining planning permission and building out the site and will receive a set margin on a phase by phase basis with any upside in profitability shared by both parties. It's essentially a "win win" for both sides as the typically cash strapped public body avoids hefty capital outlays while Vistry not only benefits from its higher predictability and recession resistant nature but is also not required to put up large sums of cash up-front to buy and work up the land and this ultimately boosts its overall return on capital employed.

Having built a large cash position Vistry has doubled down with the proposed acquisition of Countryside, which again operates both house building and partnerships businesses, for £1.2bn paid through c. £950m new Vistry shares and £300m cash. At a stroke the combined group is expected to: deliver over 18,000 homes year, almost triple the 6,551 Vistry sold in FY'21; nearly double its land bank from just under 43,000 to 81,000 plots; and significantly increase the counter-cyclical Partnerships business to more than 50% of the enlarged group's profits. At the same time deal synergies will be worth at least £50m by the end of the second full year post completion. The medium term targets are to double profitability in the medium term with Housebuilding and Partnerships' operating profit to grow from £305m and £80m, respectively, to £400m each!

Fitzgerald has also set his stall out to generate significant value for shareholders and adds that should the market be tardy in rewarding his efforts with a higher PE rating, he intends to de-merge the two businesses. In a further sign of confidence, on 8 September he acquired a further 24,699 shares (c. £200,000) at 804p. *I am following his lead and am a buyer.*

TMI



Easyjet

Sector: Travel	Share Price: 359p	Epic Code: EZJ

Key Data

Address:	Hangar 89, London Luton Airport, Luton, Bedfordshire, LU2 9PF
Telephone:	01582 525019
Shares in issue:	758m
Market Capitalisation:	£2.7bn
Next Results:	Finals: November

It's a measure of how poor investor sentiment is that even a terrific update from travel agency giant TUI, which said summer bookings in July and August had recovered to 93% of 2019 levels, couldn't lift the cloud hanging over that industry. Nevertheless, history shows that taking a contrarian approach in a beaten up sector like travel often leads to very large share price gains for those with the patience to back companies boasting market leading positions. My second share this month is therefore Easyjet, whose shares have tumbled all the way back from highs of over £15 in 2015 to the current 359p. In a similar vein to investing in residential property, where places such as Mayfair and Knightsbridge are like gold dust because of their desirability and the lack of space to build new housing, so Easyjet has its own equivalent portfolio of prime real estate in the form of landing slots in some of Europe's busiest airports including London Gatwick and Nice & Nantes in France. These positions are known in the industry as "slot constrained," which means the airport has no spare capacity to accommodate would-be new competitors, therefore providing Easyjet with extra pricing power.

Trading on dirt cheap 3.8x EBIT

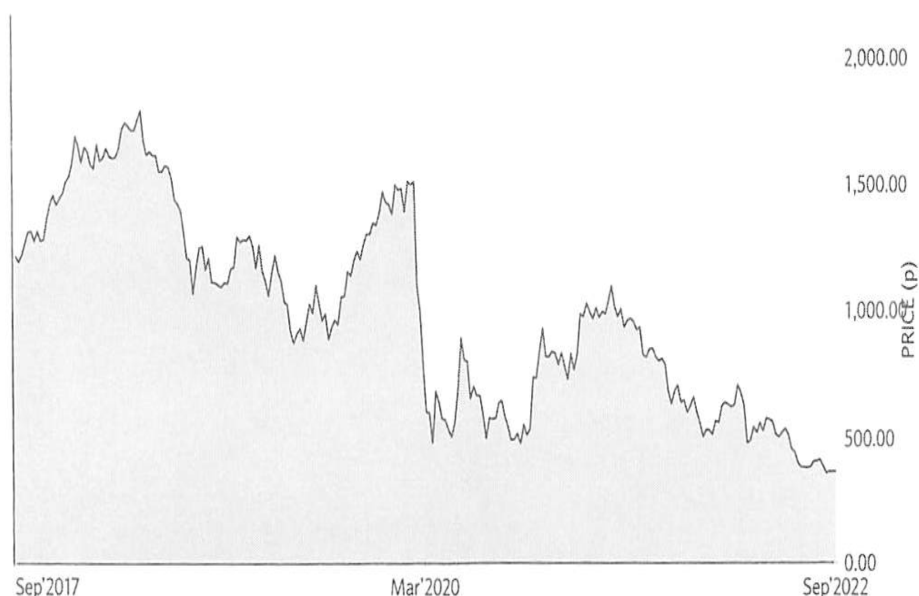
Thanks to these strong foundations Easyjet has been able to weather an extraordinary confluence of "Black Swan" events, starting with the Pandemic itself and moving on to staff shortages, rising fuel costs and the war in Ukraine. At the start of this year Easyjet was operating at just 50% capacity with a load factor (number of paid for seats / total available seats) of 68%. Capacity would have reached 97% of FY'19 levels by the fourth quarter but for said staff shortages, with Easyjet having to pare it back to 90% to prevent a continuation of those irritating last minute cancellations.

Nevertheless, with Easyjet having hedged more than 80% of its fuel requirements at US$705 / MT and 60% of H1 '23 at US$784 versus current spot prices that are more than three quarters higher, analysts expect it to return to profit and the shares trade on a paltry 3.8x earnings before interest and tax (EBIT).

Founded by Stelios

Easyjet was founded by entrepreneur Stelios Haji-Ioannou, the son of a wealthy Greek-Cypriot shipping tycoon, in 1995 with two leased Boeing 737-200 aircraft flying from London Luton to Glasgow and Edinburgh. While Stelios' subsequent ventures, such as Easy FoodStore, Easycars and Easy Hotels, have met with varying degrees of success, Easyjet's "no frills" flying with low fares has really captured people's imagination by allowing them to visit faraway places previously well beyond their reach.

Helping the company along have been several strategically important acquisitions, allowing it to quickly build scale while "grandfathering in" much sought after take-off-and-landing slots in the busiest airports.



Key acquisitions

The deal that made Easyjet one of the leading lights was its purchase of rival airline "Go!" in 2002, the former British Airways start-up, for £374m, which doubled the number of aircraft and brought in new bases at Bristol, East Midlands and Stansted airports. That same year it opened a base at Gatwick airport (now its main hub), while subsequently expanding into Germany, France, Italy and Spain.

More recently, it cherrypicked Thomas Cook's slots at Gatwick Airport (12 summer slot pairs and eight winter slot pairs) and Bristol Airport (six summer pairs, one winter) from the administrators for £36 million.

Helped by these acquisitions the company grew the number of passengers from 5.6 million in 2000 to almost 49 million in 2010 before nearly doubling again to 96.1 million in 2019. During a remarkable purple patch, turnover, pretax profit and eps soared from £263m, £22.1m and 11.9p in 2000 to a peak of £4,686m, £686m and 139.1p, respectively, in 2015 but since then the company has been forced to negotiate a series of curve balls such as the volcanic eruption at Eyjafjallajokull in Iceland,, which threw up a blanket of ash preventing air travel during 2010; a wave of terrorist attacks in Paris, Brussels, Nice and Egypt; Brexit; the Pandemic; and now the energy crisis / war in Ukraine.

£3.9bn cash reserves

Nevertheless, Easyjet has shown remarkable resilience and in spite of racking up combined losses of £2.2 billion in FY'20 and FY'21 net debt was just £0.2 billion as at 30 June '22 and it has liquidity (cash and un-used available debt) of £3.9 billion. The latter is largely thanks to a share placing and subsequent rights issue (raising £419m at 703p in June 2020 and £1,200m at 410p in September '21, increasing total shares in issue by 90% to 754m) and several sale and leasebacks of its fleet.

The recovery plan has been centred on six key areas including cost cutting (£512m in FY'21, with half considered sustainable); optimising its network by reallocating aircraft to higher contributing bases; the launch of new bases; increasing ancillary revenues; buying more efficient planes; and expanding Easyjet Holidays, which offers flexible holiday packages at keen prices. I will describe some of these in more detail below.

Operates 927 routes across 34 countries

From its headquarters at London Luton airport Easyjet operates 927 routes across 34 countries and 153 airports on a "point to point" basis with no

Shoe Zone (SHOE), 182.5p

Retail shares may be under the cosh right now but it's not all doom and gloom on the high street. One winner is Shoe Zone, which sells cheap but stylish school shoes, workwear, casual shoes and even wellington boots and recently announced that thanks to strong trading through August, driven by demand for summer products and a promising start to key "back to school" lines, combined with ongoing margin improvement means it now expects pretax profit of "not less than £10.5m for the full year ended October 2022." This is its third upgrade in as many months, with expectations back in June having been for "not less than £8.5m." Broker Zeus now expects fully diluted eps to increase from 13.5p in FY'21 to 16.8p this year.

Shoe Zone was established in the 1980s by the Smith family (controlling 53.7% interest) who have board representation through chief executive Antony Smith with the company's aim to "be the lowest priced footwear retailer." At the time the group adopted very aggressive tactics by opening new stores in close proximity to long-established rivals and exploiting its strong price proposition to drive them out of business. It would often follow-up by buying the assets of its hapless victims for a bargain and convert them to its own store format and branding. These stores would then be traded through to lease expiry and given their secondary locations, there would usually be an opportunity to negotiate lower rents or if necessary close them down and open in a better location nearby.

At its peak in 2011 the estate reached 793 stores, but the shape of retail has changed in recent years with more choice out of town where there's often more parking space and these traditional small (typically 1,500 sq. ft.) sites have become less economic. In response Shoe Zone started opening much larger "Big Box" outlets in edge and out of town locations, not only facilitating a wider range of merchandise (and widening its customer audience) but also generating greater profitability. Indeed Big Boxes are expected to make between £0.7m-£1m sales when established with a profit contribution of £100,000 versus £30-£50,000 for the smaller outlets. In its new slimmed down form it currently has 410 stores of which 343 are "Original", 51 "Big Box" and 16 "Hybrid" (looks like a Big Box, but trading on the high street in more affluent areas). The plan is to get to 100 "Big Boxes" but that has been interrupted by Covid 19, which caused havoc for the company just like every other retailer.

However, Shoe Zone has been remarkably resilient with several points of difference from rivals. First, the average store lease length is less than two years so it's been able to beat up landlords for lower rents on lease renewal (or close and relocate) and in FY'21 it saved £1.8m, an average rent reduction of 53%, while also shutting down 50 unprofitable locations! Second, Shoe Zone has invested in digital infrastructure, which paid handsome dividends when everyone was glued to their screens during Lockdown. In FY'21 digital sales increased 58% to £30.5m (26% of group) helped by a new online exclusive range, sales through Amazon and greater use of drop ship partners (where its manufacturers own the inventory to the point of sale, not Shoe Zone).

Third, Smith has made its supply chain more efficient which alongside better cost management has seen Zeus upgrade gross margin forecasts by 0.6% to 21.7% with operating margin upgraded 1% to 7.7% for FY'22.

Fourth, its financial position has improved beyond recognition and it's just paid off the Government's £4.4m CLBILS loan, while net cash is forecast to increase from £6.3m in FY'20 to £16.3m in FY'22. As a result it has started a £3.5m share buy-back program and also expects to pay a 6.8p dividend (yield 3.7%) this year. *I am a buyer.* TMI

connecting flights allowed. In the last "normal" year in 2019 before the Pandemic its biggest market was the UK (40% passengers), followed by France and Italy with c. 13% each.

The group is second only to market leader Ryanair and ahead of **Wizz Air**, 2078p, Air France / KLM, Turkish Airlines, Aeroflot and Norwegian Air Shuttle. What makes it stand out from the crowd is that it holds the number one position in 18 of its markets as well as a top five position in 11 of the largest 14 European airports, most of which are "slot constrained" where demand for runway and gate access exceeds airport capacity.

Number one at key airports

One of its most lucrative franchises is at Gatwick where it holds a 47% market share of short-haul capacity, while it also holds 43% of Luton airport. Elsewhere, it's number one in Nice and Nantes, Milan Malpensa, Naples and Venice, Geneva and Basle (Switzerland), while within the capital cities of Amsterdam, Paris Charles de Gaulle and Lisbon it's the number two player. This year alone it's added new bases at popular travel hot spots such as Porto and Lisbon and Linate (also Milan), several Greek islands and some important Croatian markets. It's also radically optimising its network, reallocating more than 1.5 million seats (c.5% seats sold in FY'21) to the strongest markets.

A key benefit for Easyjet is that barriers to entry are high as it cannot lose its take off and landing slots unless it fails to use them for the prescribed minimum amount of time, which is 80% (aside from exceptional circumstances such as Covid-19) and clearly it won't let that happen.

Ancillary revenues increasing

Alongside its strong leading position, the other factor driving its success has been its "no frills" service in which it employs an "unbundled" business model popularized by highly successful US budget airline SouthWest. This involves keeping seat costs to a minimum by charging extra for hold baggage, food and drink, blankets, priority boarding and seats near the front (so they can leave quickly) and / or with extra leg room. These so-called ancillary revenues increased 57% in H1 '22 versus H1 '19 and have increased from 22% to 32% of the average passenger yield per seat.

Yield management techniques

Easyjet also employs yield management techniques and computer algorithms to set prices dynamically, in which seats are at their cheapest when released (typically 8-11 months before departure) but become more expensive closer to their departure date. Historically, the group sold half of all seats for under £50 with the average price for a single fare being in the low £60s but I would wager that these will be significantly rising due to less competition (the effects of the Pandemic) and the need to cover cost inflation.

Easyjet's main operating costs are fuel (22% H1 '22 costs) with airport charges, ground handling, crew, navigation & flight space, aircraft leasing & depreciation, maintenance and selling & marketing the other significant costs.

Fleet upgrades planned

The fleet currently comprises 308 aircraft, of which 59% are owned and 41% leased. Just over four fifths comprise Airbus A319s and A320s but Easyjet has already started to modernise its fleet with the addition of A320 NEOs and A321 NEOs (currently 17% of the total). The latter provide 15% unit cost and fuel savings reductions over the original planes as well as a 50% reduction in noise and won't do its ESG credentials any harm. While Easyjet has been forced by the Pandemic to rein investment in, it still intends to add 33 of the new generation planes between FY'22-'24. Gross capital investment is expected to be around £0.8 billion in FY'22, rising to £1 billion and then £1.3 billion in FY'23 and '24.

Easyjet Holidays: £100m profit potential

There is also an interesting joker in the pack. The demise of Thomas Cook, which fell into liquidation in September 2019, created a large void in the UK holidays space and management spotted an opportunity to launch EasyJet Holidays two months later. The idea was to leverage Easyjet's strong brand (reducing marketing costs of

customer acquisition) and its highly scalable IT systems (including an Easyjet app and new website) to take online bookings at little marginal cost with customers able to book "Europe's most loved hotels together with an Easyjet flight" on one platform. Easyjet estimates it saves customers an average of seven hours spent searching for a holiday with customers able to choose from over 5,000 hotels across more than 100 destinations.

In FY'21 Easyjet generated a profit of £10m while in Q3 alone this year (April-June) it generated £16m profit with Easyjet on track to deliver 1.1 million passengers for FY'22. Even now Easyjet is clearly excited by the potential and believes the business could one day make a pretax profit of £100m.

Poised for market share gains

Sure, there are risks with an investment like Easyjet, most obviously a softening in demand due principally to soaring domestic gas prices but the low cost aviation industry has this summer reported demand outstripping supply and it could be argued that the savings generated by turning off the household boiler and flying out to a warmer climate in winter will match the costs of the holiday itself.

At the same time there are also huge potential prizes for the survivors of this near three-year downturn in terms of market share gains and improved pricing power. In recent years we've seen the demise of Alitalia (the Italian national flag carrier), Monarch, Thomas Cook and Flybe (UK) and with other rivals likely to run out of cash Easyjet, which has previously picked up distressed assets at knock-down prices, could be presented with further opportunities.

Albeit towards the riskier end of the spectrum, I am a buyer of the shares.

Updates, upgrades and downgrades

H&T (HAT) 470p
Sector: AIM, Financial Services

Almost immediately after the ink on my write-up of pawnbroker H&T was dry the company announced interims strong enough to drive forecast upgrades. Celebrating its 125 year anniversary, H&T said group revenue, pretax profit and eps increased 50%, 44% and 41%, respectively, year-on-year to £77.8m, £6.7m and 13.1p.

The net pledge book increased 27% year to date to £85.1m, comfortably exceeding its pre Pandemic peak of c. £72m, reflecting growing demand for pawnbroking services due to the cost of living crisis and withdrawal of competition in the unsecured lending market. The composition of the loan book has returned to pre-Pandemic levels as demand for larger loans has caught up with smaller loans.

Elsewhere, jewellery retail sales performed strongly, increasing 29% to £8.7m, with broker Shore Capital expecting an even stronger H2 given the normal seasonal bias.

Revenue from "other services" (gold purchasing, pawnbroking scrap, foreign currency, money transfer, cheque cashing, personal lending) rose 13% to £9.4m. Foreign currency (travel picking up) and gold purchasing (customers selling jewellery to pay bills) were hot spots, offset by the winding down of personal lending.

Operating costs rose 7% due to wage and salary rises plus IT infrastructure upgrades and store roll-outs (4 in H1, a lot more in H2) but the pace of cost growth is expected to moderate in H2.

Shore Capital has upgraded pretax forecasts for FY'22-'24 by a massive 18%, 37% and 30% to £18.7m, £28.8m and £33.6m for new eps of 36.5p, 56.3p and 64.3p.

The last time eps went above 50p was during the early 2010's gold spike but this surge looks far more sustainable. Even after the rise, the soon-to-be prospective PE for FY'23 is still only 8.3. *I am a buyer.*

Essentra (ESNT) 194p
Sector: Industrial Services

Although the shares have been whacked, Essentra has done little wrong and first half results came in bang in-line and the group having sold its non-core packaging business for £312m.

Its plan is to focus exclusively on its industrial components business, which makes and distributes caps, plugs and cable ties. This side grew like-for-like sales by 13%, of which 10% was price increases to offset cost inflation. While others have seen profitability pruned back, this side actually increased operating margins by 2.2% to 20.4%, driving a one third increase in operating profit to £35.9m.

Its other legacy business slated for disposal is cigarette filters, which grew underlying sales by 15%. With operating margins up 1% to 9.2%, profit increased 31% to £15.1m.

Removing Packaging would reduce pretax profit forecasts by 28-34%, while FY'21 net debt of £235m would swing to net cash of c.£30m at FY'22, says Numis, leaving power to add for acquisitions. The broker also says if Filters is disposed of for the c. £235m valuation in its sum of the parts analysis (6.5x FY'23 forecast EV / EBITA) then Components is trading on an implied EV / EBITA of just 7.5x versus a peer group average of c. 17x.

The shares are in bargain basement territory now; any director buying would clearly confirm an outstanding entry level.

Cake Box (CBOX) 140p
Sector: AIM, Tourism & Leisure

Cake Box, which operates a chain of franchised egg-free cake shops to which it supplies the sponge base, cream and other ingredients, said that more challenging trading conditions means it now expects full year profitability significantly below forecasts. Going into the summer it already anticipated some softening because of the cost of living crisis but added problems came from rising costs such as cream and the heatwave in July and August putting people off eating cakes.

In response, Shore Capital cut pretax profit forecasts by £2m to £5.3m for this year and by just over a quarter to £5.8m for FY'24.

Net cash was £6.8m at 31 August, before paying out a £2m dividend while reassuringly, CEO Sukh Chamdal has acquired a further 225,000 shares at 122p taking his holding to just over 10 million (25%).

This is a highly cash generative business and my gut feel is that cakes are a small treat people will be loath to cut out, even in these tough circumstances. *Fast forward 18 months and the current price could look like bargain levels. Strong hold / buy.*

Lords (LORD) 71.5p
Sector: AIM, Construction

Lords reported record revenue of £214m (+19.7%) for the six months ended June with EBITDA up 27% to £14.2m.

The Merchanting side was strong with like-for-like sales up 14.5% to almost £106m, helped by four acquisitions since July '21. While EBITDA margins declined from 8.7% to 7.3% that was in line and reflected customer mix and a lag between increasing prices to cover rising costs and the change taking effect. Broker Cenkos believes it's "continuing to gain market share, with its continued focus on range extensions and new site openings."

The Plumbing & Heating side saw revenue down 12.5% to £108.3m due to the boiler component shortages despite strong demand. The situation was easing by the June exit date and is expected to further recover.

As well as Lords' target for 3-4 acquisitions a year Cenkos highlights the organic growth opportunity. Lords still has less than 1% share in its markets and new product areas include energy efficiency tech (helped by Government's "green initiatives") where it's gained several new supply agreements. It's also expanding Mr Central Heating from nine locations (delivering £55m sales) to 50 locations nationwide.

Cenkos reckons Lords will achieve its FY'24 target for revenues of £500m and EBITDA margin of 7.5% (i.e EBITDA of £37.5m) versus current EBITDA forecasts for £26.7m (eps: 7.7p) this year and £30.2m (8.6p) next.

With the shares on a prospective PE of 9.3 and then 7.9. *I am a buyer.*

At the time of going to press, the editorial team held the following shares mentioned in this issue: Easyjet

Updates, upgrades and downgrades

Energean (ENOG) 1392p
Sector: Fossil Fuels

The shares soared above £14 after Energean reported a robust operational performance and fast tracked commencement of a maiden quarterly dividend of 30 US cents (costing US$50m), around three months ahead of schedule. This is expected to rise to 60 cents a quarter as production from its flagship *Karish* gas field in Israel, where first gas is expected "within weeks," ramps up. Net debt was US$2.2bn.

Interim results showed revenues of US$339m, EBITDAX (i.e. EBITDA profit less exploration costs) of US$198m and production of 35,400 barrels oil equivalent per day. Full year guidance is for 34-37,000 barrels (ex Israel) changed from previous 35-40,000. Israel (i.e. Karish) is expected contribute between 15-25,000 in Q4 this year.

ENOG also expects new production coming on stream, after further drilling success in Israel including the *Athena* prospect. Next up for drilling is Hermes (potentially worth 187p "un-risked" to NAV) and Zeus (74p un-risked) and as these form part of the same structural trend that includes Athena, there's a high geological and commercial chance of success according to broker Peel Hunt.

Investec now expects EBITDAX of US$941m this year, rising to US$2,013m in '23 and US$2,690m in '24. The broker forecasts 141 cents payout in FY'23 and 169 cents in '24 and has a 2600p price target. *Originally a main write-up at 515p in August '18, the shares have gained 170%. I would be inclined to top up on any dips*.

Diversified Energy (DEC) 130p
Sector: AIM, Oil, Gas & Coal

Diversified Energy (DEC) purchases multiple portfolios of mature, low risk gas wells in the US, where it uses technology to wring out improved production performance. While not as dramatic as the energy spikes in the UK, the Henry Hub gas prices in the US have nevertheless risen from around US$3 / MMBTU (that's one million British Thermal units) to over US$8 (down from a high of US$10) and while DEC is obliged to hedge forward because of the debt it has taken on, it will eventually benefit should prices stay elevated, which largely explains the shares briefly spiking to a high of 142p. Meanwhile, DEC is also a generous dividend payer; the latest quarterly payout was 4.2 US cents (3.7p), with sterling weakness giving shareholders more bang for their buck.

Interims showed EBITDA rising 48% to US$224m, supported by the acquisition of East Texas assets with cash EBITDA margin of 48%. Net debt was US$1.1 billion (net debt / EBITDA 2.2x) while liquidity was US$469m. Encouragingly, production picked up in Q2 to average 136,000 barrels oil equivalent per day (boepd) after weather related disruptions in Q1.

DEC made another acquisition in July of around 1,500 gas producing wells from ConocoPhillips in Oklahoma and Texas for an estimated US$210m. With the assets making US$82m, exit multiple is just c. 2.5x before anticipated synergies. This is its sixth major deal in the Central region and will add 31 million barrels oil equivalent to reserves.

Stifel's broadly unchanged forecast is for a pretax profit of US$168.4m (average production: 139,300 boepd) and dividends of 17.3 cents (15.2p) for a yield of 11.7%.

It's warm and cosy in this sector given the carnage that has been endured elsewhere. A pleasant hold.

Lok 'n Store (Lok) 955p
Sector: AIM, Real Estate

Self storage is one of the few sectors to be spared a hammering by investors as demand continues to hold up following the Pandemic boom in home moving, while new supply is constrained by the UK's tough planning rules.

In an update for the period ending 31 July, Lok 'n Store said self storage revenues have risen 17.3%. Q4 saw Lok let out another 55,479 sq ft. (FY'21, Q4: 58,125 sq. f.) and while occupancy is down from 85.8% to 80.3%, that largely reflected the addition of more space from newly opened stores and the sale and manage back of four older stores in January 2022. Same store pricing was up 12.3% year-on-year.

During the year Lok opened three new stores in Warrington, Wolverhampton and Stevenage, taking the total to 40 and early trading was said to be excellent. The secured pipeline will increase its owned trading space by a further 44% and it's on site at four locations, all of which will open in 2023.

Final results are due on 31st October. *I am holding*.

Hostelworld (HSW) 75p
Sector: Tourism & Leisure

There's a two-way pull in sentiment for travel shares with hopes surrounding the opening up of activity post Lockdown tempered by the impact on consumer budgets of the rising cost of living. Hostelworld, the online provider of hostel accommodation, is better positioned than most because its customer base is weighted towards younger people who are less likely to have hefty mortgages while its products are more affordable than, say, luxury hotels.

At the start of the year bookings were still only at 30% of FY'19 levels but this has improved to 80% in June. This momentum was reflected in interims, which showed net revenues increasing from €2.9m to €28m driven by pent up demand as restrictions were eased. Net average booking value increased 35% to €15.82, driven by a favourable geographic mix, price inflation, recovery of bed prices and longer stays. Adjusted EBITDA losses were €5.2m.

Numis says a key question is whether Hostelworld is doing enough to differentiate itself from larger generic rival, Booking.com. The broker says it's just gone live with new social innovations such as HostelChat/CityChat and direct messaging to other guests, which are expected to increase usage of its app and give travellers an incentive to book via Hostelwold.

Numis forecasts revenues of €59.5m this year, rising to €82.2m in FY'23 for a loss of €7.7m, and then a pretax profit of €5.4m. By FY'24 the broker expects free cash flow of €16m. Cash of €23.3m should tide it over until then. *I am holding for potential signs of an earlier recovery*.

UP Global Sourcing (UPGS) 108p
Sector: Household Goods

UPGS issued a resilient year end update (period to 31st July). Group sales rose 13% to £154.2m (1% like-for-like) driven by the Salter acquisition, with growth underpinned by sales to supermarkets (now its largest channel) including international markets in Europe. Sales via online channels had suffered a wobble in H1 '22 due to supply chain issues but recovered well in H2.

Encouragingly, tight cost control meant EBITDA margins rose 2.5% to c. 12.2%, in turn driving EBITDA up over 40% to a record £18.8m (Shore Cap forecast: £18.7m) with pretax profit also ahead over 40% to £15.8m (eps 13.8p).

Shore Capital has lowered its net debt forecast by £3m to £24.5m, leaving headroom of £17.8m.

The broker suggests UPGS' value oriented household ranges, plus the broadening of its sales channels (Supermarkets, Online, Discounters, International) are a virtue given the challenging macro environment. It also highlights an expected dividend of 6.9p for a chunky yield of 6.4%. *I am a buyer*.

S4 Capital (SFOR) 152p
Sector: Media

The shares fell after S4 said that although like-for-like sales growth is in line with full year expectations of +25%, EBITDA and margins are below. As a result, broker Dowgate has lowered FY'22 EBITDA estimates by 24% to £120m.

By division, Data & Digital Media and Technology services delivered "healthy" margins but increased costs (including significant investment in hiring) have impacted margins in Content. S4 has therefore introduced mitigating measures including a brake on hiring and cost controls. Net debt finished the period at the lower end of £140m-£190m guidance due to improvements in working capital.

S4 had previously flagged that FY'22 EBITDA will be skewed to H2 and Dowgate suggests a £39m:£118m H1:H2 split for FY'22, recovering to £179m in FY'23. Corresponding eps are 12.3p and 18p. *A main write-up back in November '20 at 380p, I sold half at 772p a year later, leaving the rest in for free. The challenge for CEO and founder Sir Martin Sorrell will be to generate organic growth as deals cannot be funded by its lowly rated paper. I'm backing him for now. It's also good to see cluster buying by directors. A strong hold*.

TMI Trader Portfolio 2

Few could have foreseen the sheer scale of Prime Minister Liz Truss' energy intervention with the two-year guaranteed (six months for businesses) price cap rise in annual household energy bills limited to just £2,100 - they could have hit over £6,000 next April without taxpayer support. This should prevent the bottom dropping out of the UK economy and will be good for domestically focused shares.

Amongst our constituents, news has been fairly light. H&T said its pledge book increased 27%, reflecting growing demand for pawnbroking and leading to massive eps upgrades. A nice gain so far but the soon-to-be prospective PE is only 8x. Essentra's interims were in line and its plan to focus on the higher margin industrial components business is on track following the sale of healthcare packaging.

This time I've led with Playtech, which provides software and services for gambling firms with mainland Europe and the Americas the territories with the hottest growth, driven by the rise in online gambling (forecast to grow from US$57 billion in 2021 to US$153 billion by 2030) and innovation such as linking casino and poker accounts to create mega jackpots. For many months it was subject to bid interest from three parties but they later melted away and the shares have dropped from nearly £8 to the present 455p. However, in July it said trading was ahead of expectations and four directors acquired 121,000 shares (some in accordance with their remuneration policy) around these levels. Assuming the shares don't pop after interim results (due two days before this issue lands) I intend to add a unit. Cash is scarce so I will need to sell a laggard (SigmaRoc or VP) to release funds.

My other write-up, low cost airline, Easyjet, is one of many shares out of favour with investors due to macro concerns as well as the bout of summer flight cancellations. But the group owns a valuable portfolio of take off and landing slots at some of Europe's busiest airports and has seen demand recover towards pre-Pandemic levels. Armed with liquidity of £3.9 billion Easyjet is well-placed to exploit weaker rivals going bust, by acquiring their landing slots and raising prices. Like Playtech, Easyjet has also been subject to bid approaches in the past. Trading on a prospective EBIT of less than 4x the shares look good value.

Elsewhere, I've written about a couple of UK house builders, Crest Nicholson and Vistry, which could bounce if the Prime Minister's interventions improve prospective buyers' affordability tests. Vistry has just announced the take-over of rival Countryside and is probably the one with longer legs, with significant non-economic drivers (£50m deal synergies) underpinning future eps growth.

PERFORMANCE TABLE

	Current Value	Change on One Month	Change Since Start
TMI Trader Portfolio 2		-5.7%	-7.6%
FTSE-100	7282	-2.5%	+23.3%
FTSE-All Share	4000	-3.2%	+20.3%

TMI TRADER PORTFOLIO 1

Starting Capital (25.3.02):	£100,000
Termination Value (11.12.20):	£618,710
Portfolio gain:	+518.7%
FTSE-100 gain in period:	+24.7%
FTSE-All Share gain:	+44.6%

EPIC	Quantity	Description	Date Bought	Acquisition price (p)	Book Cost (£)	Current Price (p)	Current Value (£)	Change (%)
DX.	45,000	DX Group	16/11/20	19.5	8,820	30	13,500	+53
DLAR	5,000	De La Rue	16/11/20	168	8,487	92.5	4,625	-46
CAML	4,250	Central Asia Metals	21/12/20	224	9,565	230.5	9,796	+2
SOM	2,500	Somero +	12/2/21	339	8,520	410	10,250	+20
RCH	3,600	Reach	21/6/21	263	9,560	77.7	2,797	-71
VP.	1,000	VP	19/7/21	950	9,593	802	8,020	-16
ESNT	3,000	Essentra	22/11/21	314	9,465	194	5,820	-39
SUR	12,000	Sureserve	10/3/22	79	9,525	83.5	10,020	+5
SRC	11,000	SigmaRoc	16/3/22	83	9,175	40.5	4,455	-51
BAB	2,800	Babcock	14/4/22	323	9,044	322	9,016	-1
HAT	2,600	H&T	7/7/22	361	9,431	470	12,220	+30

Stock value	£90,519
Cash	£1835
Total fund value	£92,354

* Part profits taken + Acquisition price adjusted for two special dividends

Starting capital £100,000 (December 2020)

Current holdings in the portfolio are valued at mid-prices and include dealing commission

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• *Unless otherwise stated, share prices quoted are correct as at 15/9/22*

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