GCI
GROWTH COMPANY INVESTOR

www.growthcompany.co.uk NOVEMBER 2019

Shutterstock.com

Objective met

In spite of a poor market backdrop, the GCI Income Portfolio continues to deliver on its brief to generate a healthy income from a selection of small caps

Bonhill

Contents

Shutterstock.com

Shutterstock.com

Editor's Opinion

David Thornton

There are two common problems faced by private investors. One is obtaining information about the companies they own; the other is avoiding dilution by participating in fundraisings.

In the internet age information has become much less of an issue. Stock exchange announcements are available to us at the same time institutions see them and we can listen into post-results conference calls. Company websites make annual reports and presentations downloadable at the click of a mouse. When I started my career as an analyst, getting hold of the report and accounts meant phoning the company's registrar and waiting a few days for the postman to deliver it. There is no question that private shareholders are in a vastly stronger position today than they were a generation ago.

But one bugbear remains. There is an irrational refusal by boards to include consensus forecasts in their announcements. Performance is discussed relative to "market" or "management" expectations; but without divulging any numbers. And when there is a profit warning brokers are guided to what the new numbers are, but the official announcement will use words like "marginally" or "materially" below forecasts. So if we cannot see the broker note we have to guess what the revised eps number is, or wait until a consensus earnings source picks up the change.

As Editor of *GCI* I am lucky in having access to broker notes. Occasionally, however, the ridiculous Mifid II rules are invoked as a reason not to share a research note; or at least to make me work harder to ferret out the information. Quite how the rule-makers think this supports a fair market is anyone's guess.

Like information, fund raisings are also improving for private investors, but are not quite there yet. This month Duke Royalty offered private investors a chance to participate on similar terms to institutions. Unfortunately it was via the Primary Bid platform over a weekend. So investors could easily miss the news or might not be registered with PB. Duke then provided an open offer, albeit in limited size. The company should be applauded for trying, in contrast to most. If open offers become the norm along with consensus forecasts in RNS announcements, we will have a lot less to grumble about. ■

The next issue of *Growth Company Investor* will be published on **29 November 2019**.

GCI's Investment Policy

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

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

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

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

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

EDITORIAL Editor David Thornton, david.thornton@bonhillplc.com **PRODUCTION** Phil Turton **SUBSCRIPTIONS** Vanessa Khan 020 7250 7010 **ADVERTISING Sales Manager** Andrew Dodds 0207 250 7033 **BONHILL EVENTS Events Manager** Jenna Read 020 7250 7050 **BONHILL GROUP PLC Chief Executive Officer** Simon Stilwell 020 7250 7010 **MD – Events & Marketing** Nicola Dowdall 020 7250 7010 **Finance Director** David Brown 020 7025 7063 **Sales Manager (Technology titles)** Jon Sumner 020 7025 7032

Bonhill

Bonhill Group Plc, 14 Bonhill Street, London EC2A 4BX
Tel: 020 7250 7010 **Email:** info@growthcompany.co.uk
Web: www.growthcompany.co.uk

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

Shutterstock.com

Demand for complex steel frames plays into **Billington**'s hands

Structural steelwork contractor boasts interim sales boost and looks set to beat forecasts

The business

Billington is a structural steelwork contractor that has been operating for over 70 years, with plants in Barnsley and Bristol capable of fabricating over 35,000 tonnes pa. It also operates closely-related businesses in the fabrication of steel staircases and the provision of safety products for the construction industry – mainly site perimeter barriers and fall prevention systems.

We first spoke to management in late 2014 after the company had undergone a significant restructuring following the recession. Mark Smith was chief operating officer at the time and has subsequently stepped up to become CEO. Back then he told us the board had decided to "grasp the nettle" by closing offices to centralise on Barnsley, shrink the workforce by 25%, and move to a single shift. This helped to stabilise the business and move it back into profit. Capacity also left the industry as competitors failed or restructured, so the improved economic background has subsequently led to much healthier returns.

Trends in the construction market are also helping. Huge distribution warehouses for the e-commerce industry require the sort of large-scale, complex structures that Billington specialises in, as do data centres. The company has also had success in working on major city centre redevelopments, with commercial building being especially vibrant in places like Leeds, Birmingham and Manchester. The strategy has been to focus on larger-scale, high-end projects. These tend to be less competitive and offer better margins since there are only four or five firms with sufficient capacity to do this work.

Working with large clients is also taking Billington into Europe, providing some geographic diversification. It is currently delivering a data centre in Belgium which helps underpin second half results. An extremely large unnamed

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

e-commerce company which has used Billington for warehouse structures in the UK is discussing a framework agreement for its future European projects. The company has been active on the continent in the past, but not on this scale. As well as having the right machinery and facilities, the company also has an edge from its in-house engineering design and ability to provide a turnkey product including site safety, steel stairs and secondary steelwork.

Raw material price risk is managed by locking input prices in at the start of a project. The company has a close relationship with British Steel which manufactures from iron ore. The future ownership of British Steel is unclear; but Billington also uses Arcelor, which makes steel from scrap, and has access to a range of international suppliers. Brexit risks have been mitigated by dual certification and CE marking, along with using EU-based hauliers. Happily the company has avoided exposure to some of the more troubled larger contractors in the construction industry and assesses risks on an individual project basis, taking out credit insurance on significant projects.

Management and finances

As already mentioned, Smith became CEO in 2015 and has over 35 years experience in the industry. Finance director Trevor Taylor has been with the group since 2008 and in his current role for eight years. There is a significant shareholding adding up to over 50% of the equity held in trusts related to the founder which are represented on the board by a non-executive director. The shares do trade but this has an inevitable impact on liquidity.

Cash stood at £10.7m in the June balance sheet alongside £1.6m of long term debt and the board expects Billington to "remain cash generative in the second half". The aim is to align cash with profits and to be neutral on working capital with clients paying for work ahead of the settlement of steel purchases. The dividend has been covered 2.6x and paid as a single final with nothing at the interim stage. There is potential for the company to be a little more generous here while continuing to invest more than the depreciation charge.

Valuation and outlook

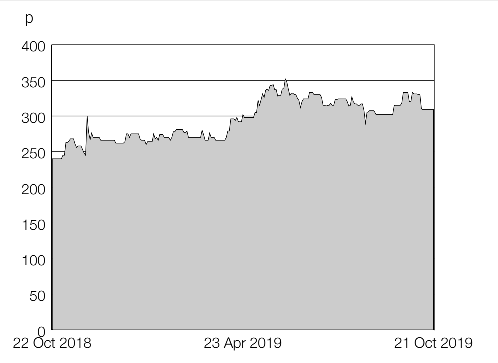
Management described themselves as "cautiously optimistic" when we spoke recently. Given the relatively long term nature of its large-scale projects there is decent visibility into next year and the order book "remains at strong levels". 2020 is said to have similar visibility as 2019 had at this time last year: so there has been no deterioration in outlook. The company won two large UK-based contracts in June worth £30m and the Structures arm is more of less sold out for the rest of the year. Management "continue to see a number of significant prospects" and the potential to win large contracts in Europe is a further encouragement. Clearly big construction projects are vulnerable to a significant economic downturn and the shares should not be bought if one is envisaged. However the company looks set to do well in a continuation of today's slow but steady backdrop.

The stock trades on a modest single figure multiple and offers a good yield. There was a 13% earnings upgrade when the last set of finals was announced in April. Despite this revenue is still only expected by the company broker to rise 1% for 2019. This does not seem right since the interims showed sales ahead by 20% to £47m. This implies a drop in second half revenues from last year's £38m to £31m for that forecast to be correct – which seems unrealistic in the context of a full order book and optimistic management outlook. This conservative forecast should be beaten and sustain the positive momentum being enjoyed by Billington. ■

BILLINGTON HOLDINGS ▶ READ MORE

www.billington-holdings.plc.uk

GCI Recommendation – **BUY**



Ticker: AIM: BILN
Sector: Construction & Materials
Mid-price: 309p

Spread: 302p-316p
12-month high/low: 352p/240p
Market cap: £40m

RESULTS	Turnover (£m)	Pre-tax profit (£m)	EPS (p)	DPS (p)	p/e	Yield (%)
Dec 2017 (A)	73.5	4.4	29.1	11.5	10.6	3.7
Dec 2018 (A)	77.3	4.9	33.6	13.0	9.2	4.2
Dec 2019 (E)	78.0	5.2	34.1	13.0	9.1	4.2
Dec 2020 (E)	80.0	5.4	35.4	13.0	8.7	4.2

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
Severfield	SFR	236.1	21.3	12.1

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

Shutterstock.com

Booming pharma R&D underpins **Instem**'s healthy growth prospects

Impressive client base and solid fundamentals make specialist software provider a buy

The business

Instem is a specialist software provider to the healthcare industry. It provides programs that help pharmaceutical companies and contract research organisations collect, analyse and report on R&D projects. With regulatory agencies now requiring drug trial data to be filed electronically, Instem also provides software and outsourced services for submitting data packages to these bodies. It counts all of the world's top 25 pharma companies as customers and has over 500 in total worldwide.

Drug research and development is a growing market, with 2018 seeing record numbers of new drug approvals and projects in the pipeline. This is especially the case in early stage R&D projects which is where Instem specialises: the number of preclinical and phase I studies have grown consistently since 2013, rising by 50% over the last six years. The company's recent performance in this segment shows it is benefiting from this background. The latest half-year period was the strongest ever for its Provantis product with nine new wins. This software suite manages data generated from non-clinical studies and a further four deals have been concluded in the third quarter. The Notocord product, which was acquired in 2016, captures safety and toxicology data and is also growing strongly. Alphadis is Instem's early-stage clinical product and has been expanded to provide full clinical trial management.

Once Instem has its foot in the door it can sell more research study modules and products. This extends to its Regulatory Solutions services. The FDA has introduced its Standard for Exchange of Nonclinical Data (SEND) which specifies the way this data must be captured, presented and submitted as part of the regulatory process. Instem has a leading SEND software solution and also runs the largest team in the industry providing an outsourced service to pharma companies who need to convert their data into the correct electronic format.

The accessible market here is expected to grow from $8m in 2017 to over $60m in 2021 as the pharma industry addresses its backlog of studies and Instem is targeting a 20% share of

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

this. Outsourcing revenue has doubled over the last year to a £5m run rate and CEO Phil Reason told us SEND services are now "coming of age".

A newer development is the Informatics division built on Instem's KnowledgeScan artificial intelligence software. This uses a 'big data' approach to supporting researchers with the initial product being "target safety assessment". Early-stage researchers will have lots of biological targets but limited in-house resources to assess them. KnowledgeScan sifts all the global published information surrounding a target's safety risks for the client before it starts expensive preclinical or clinical testing, potentially saving significant costs in time and money. Informatics revenues are still modest but grew 47% in the latest period. Four clients placed repeat orders in the first half of the year, with a top-ten pharma company placing multiple orders, and five new clients adopted the service.

Informatics is based on a platform that was acquired a few years ago and deals to add related products and capability are on the agenda. These are more likely to be bolt-on acquisitions according to management, since larger deals are harder to find and complete.

Management and finances

Reason has been CEO since 1995 and has a 4% equity stake, while CFO Nigel Goldsmith joined the company in 2011. The company floated on AIM in 2010 and last raised equity in a 2016 placing of £5m at 200p. The shareholder register is headed by Lombard Odier on 18%, Liontrust have 10%, and Hargreave Hale 7%.

The first half cash performance was notably strong resulting in a £6m net cash position at June, although like many small growth stocks it does not pay a dividend. As a long-established business the company has a pension fund which currently has a £2m deficit. One factor to be aware of is the ongoing transition to SaaS (cloud-based Software as a Service) delivery of software services. Big pharma companies used to prefer on-premise licences but are now moving over to the SaaS model, which brings Instem better revenue visibility from longer term contracts which are more valuable over their lifespan than licences. Fees in the first year of a SaaS deal are lower than from a licence sale, but SaaS provides higher annual revenues in subsequent years. This explains the acceleration in earnings next year with the transition happening quicker than expected.

Valuation and outlook

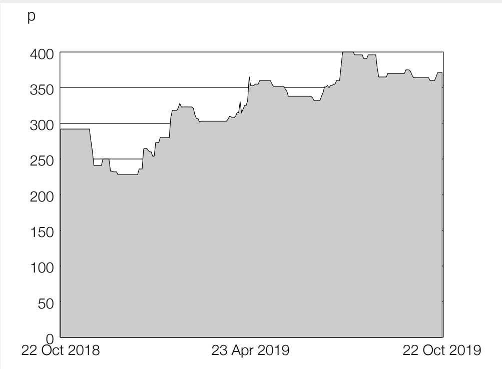
Instem serves a growing segment of the pharmaceutical and biotech industry. The core business is trading well and benefiting from the strong background in early-stage drug research. The company has successfully moved into the closely-related fields of SEND data submission and Informatics which are at earlier stages of the growth curve. It is nicely profitable and cash generative and should be capable of further margin expansion as revenues grow. The first half performance was positive and there was "strong order intake and pipeline growth", which should underpin the outlook.

The prospective p/e of 17.5x looks attractive for an established software business serving a growing industry. The stock traded in the low 300p region last year before a fourth quarter stock market-related drop to the 230p level. Since then we have had a strong recovery with the shares hitting an all-time-high of 400p in July before easing back to the current price. There have been a few bids in the software sector this year and while we have no reason to suspect Instem might be vulnerable, it would not be a great shock if someone were to take a look. Regardless of any corporate activity, the fundamentals support a buy recommendation. ■

INSTEM ▶ READ MORE

www.instem.com

GCI Recommendation – **BUY**



Ticker: AIM: INS
Sector: Software
Mid-price: 371p
Spread: 362p-380p
12-month high/low: 400p/228p
Market cap: £60m

RESULTS	Turnover (£m)	Pre-tax profit (£m)	EPS (p)	DPS (p)	p/e	Yield (%)
Dec 2018 (A)	22.7	3.0	16.5	–	22.5	–
Dec 2019 (E)	25.7	3.3	17.5	–	21.2	–
Dec 2020 (E)	28.3	4.3	21.2	–	17.5	–
Dec 2021 (E)	30.3	4.7	23.0	–	16.1	–

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
EMIS Group	EMIS	674.9	29.1	19.3
Craneware	CRW	567.3	$18.3m	38.1

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

Shutterstock.com

Deepening and expanding a quality client base key to **Eagle Eye**'s success

Software that bridges the world of clicks and bricks is proving a hit with big retail names

The business

In the pre-internet era, retailers looking to offer promotions to their customers had to rely on paper coupons randomly posted through letter boxes or published in newspapers for consumers to clip. Sales might respond to the campaign but the retailer would be none the wiser about who was taking up the offer and why some promotions were more effective than others. It brings to mind the old observation about half the money spent on advertising being wasted, but no one knowing which half! Nowadays the digital world provides ways of targeting consumers with the right profile and enticing them into store to spend with personalised offers. Eagle Eye's AIR software platform helps retailers do this by bridging the worlds of clicks and bricks.

Retailers and brand owners use AIR to manage loyalty programmes, issue gift cards and send promotions to specific individuals. These are usually digital offers but the system also works with paper coupons; either way the coupon or code issuer knows in real time when a deal is redeemed and where. This allows them to tweak promotions to increase their effectiveness and to offer further deals on a timely basis. The key point is that AIR offers performance marketing – its success in terms of redemption rates and driving traffic is immediately measurable. Consumers can be offered a digital wallet to store all the offers from a given retailer and scan them at the checkout, which is easy to use and fosters loyalty. Retailers learn more about their customers for less outlay; when an offer paid for by a brand gets redeemed it provides the retailer with information about the whole basket.

Eagle Eye's largest customer is Canada's leading grocery chain, Loblaws. The top five customers account for over 50% of revenues, but there is a long tail of good quality names. Loblaws has a local team to support the relationship and a further push into North America has recently been initiated through a deal with News America Marketing. It organises in-store promotions on behalf of brand owners and Eagle Eye is

New Recommendations

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

providing the digital element in what is traditionally a coupon-clipping market. The link up should help open doors to direct relationships with US retailers.

Sainsbury's is an important client in the domestic market and the company boasts relationships with a wide range of blue chip names like M&S, Asda, Waitrose and John Lewis. It also works with leisure sector businesses like Ask, All Bar One and Greggs; as well as directly with brands such as Coca Cola, Heineken and Irn Bru. A key element of the strategy is to deepen the relationship with these companies and encourage them to use the AIR platform for more programmes. For example, Dobbies Garden Centres started using the system to manage staff rewards as a trial and then expanded it to manage its customer loyalty programme. Management say that customers usually add a second service after two years.

Adding on extra functions is one way of growing the value of a contract over its life but potentially the most exciting element of the business model is transaction fees. There is a typical software licence fee, but Eagle Eye also takes a fee related to the number of redemptions, which aligns its interests with the success achieved by its customers' promotions. The company's early experience suggests that £1 of revenue in the first year of a contract becomes £3 after three years as transaction revenues kick in and extra services are taken.

Management and finances

The company came to AIM in 2014 at 164p and raised a further £6m at 225p in 2017. There was £1m of net debt in this June's year-end balance sheet and the company has a £5m borrowing facility. Forecasts see the debt position peaking this year at £2.6m and then being eliminated as profits build in the June 2022 year. Gross margins are 90% plus which is to be expected in a software business; profitability will come from scale economies as operating costs are forecast to grow 25% over the next two years, while revenue climbs 49%. Transaction fees have the potential to boost margins significantly since there is little or no cost attached to these.

Tim Mason has been CEO since 2016 and has a retail background, having spent most of his previous career at Tesco, rising to become deputy CEO before leaving in 2012. Steve Rothwell founded Eagle Eye in 2003 and is chief technology officer. Mason and Rothwell own 3% and 6% respectively, while former Tesco CEO Sir Terry Leahy has 9%. Cavendish, Hargreave Hale and Herald are institutional holders.

Valuation and outlook

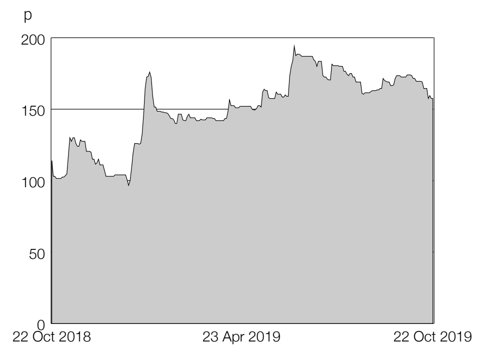
The shares are roughly the same price they floated at five years ago, though they did spike up to 300p in 2017 only to slide down as low as 100p during last year's bear market. This year has seen them trade in a 140p-180p range; so the current level does not seem to be a bad one to consider buying the stock. A current year sales multiple of 2x looks good value, with software companies often commanding 3-4x multiples. That is especially the case given the strong sales growth currently being achieved, up 23% last year. Of course we do not have earnings just yet, though these should be coming over the horizon fairly soon.

Eagle Eye provides important tools to retailers and brand owners which are required for success in today's bricks and clicks world. The company has recently signed a five year extension to its Waitrose contract which illustrates both its minimal churn rate and the quality of its client base. There is the North America initiative and clients have also been won in Australia, with the new financial year said to have started with "a rapidly expanding pipeline of UK and international opportunities". It is also comforting that strong growth should be generated by deepening existing relationships and from rising transaction fees as these relationships mature.

EAGLE EYE SOLUTIONS GROUP ▶ READ MORE

www.eagleeye.com

GCI Recommendation – **BUY**



Ticker: AIM: EYE
Sector: Software
Mid-price: 157.5p

Spread: 155p-160p
12-month high/low: 194p/97p
Market cap: £40m

RESULTS	Turnover (£m)	Pre-tax profit (£m)	EPS (p)	DPS (p)	p/e	Yield (%)
Jun 2019 (A)	16.9	(2.0)	–	–	–	–
Jun 2020 (E)	20.9	(0.5)	–	–	–	–
Jun 2021 (E)	25.2	1.0	3.7	–	42.4	–
Jun 2022 (E)	28.2	2.4	7.8	–	20.1	–

SECTOR PEERS	Ticker	Market cap (£m)	Pre-tax profit (£m)	p/e
Attraqt Group	ATQT	61.2	-2.7	-12.7
DotDigital Group	DOTD	286.6	11.0	26.8

Recommendation Updates

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

SUMO — BUY

Date recom'd	Recom'd price	Price now	Gain
Jun '18	132.75p	156.5p	18%

Sumo provides investors with exposure to the video games industry without the same level of risk carried by game publishers. The company co-develops AAA rated games for title owners who are typically blue-chip clients like Microsoft, Sega, Sony and Apple. There is good multi-year revenue visibility with milestone payments as development projects progress, followed by royalties: next year's revenue is over 40% covered already.

In most cases Sumo works on projects from the original concept onwards and is very much an integral partner in game development, rather than simply providing outsourced services. The company also develops smaller games using its own IP and funds which helps foster the creative talent of its teams and retain staff, as well as adding higher margin revenue.

Sumo has done four acquisitions and growth depends on adding development capacity headcount. Employee numbers are expected to rise to over 750 by the end of the year from around 600 last December. Management say they would like to do a larger deal if possible and are prepared to look abroad, which could help expand the company's client base by geography and genre.

Three customers represented 65% of first half revenues but within that there were eight distinct projects. So while margins will inevitably be lower than those enjoyed by game IP owners and growth requires investment in human capital, Sumo continues to offer an effective way of playing the industry on a prospective p/e of 20x for mid-teens growth. ■

Shutterstock.com

Sumo: an effective way of playing the gaming industry

Shutterstock.com

Tristel: huge potential for growth in the US

TRISTEL — BUY

Date recom'd	Recom'd price	Price now	Gain
Nov '15	122.5p	292p	139%

We moved the supplier of infection prevention products to hospitals to a 'Hold' when the shares got up to the 300p mark. The stock has continued to trade around that area for the last two years, apart from a dive down to the 220p region during last Winter's bear market. The fundamentals have remained in place throughout, it was simply a case of the valuation getting ahead of the game. After this extended consolidation it might soon be time for a renewed upward move. The year to June saw 10% underlying revenue growth which is at the low end of management's newly-stated target of 10-15% pa over the next three years. The relatively mature UK market is performing well, up 9% last year, but the engine of growth continues to be overseas markets.

Tristel has acquired its distributors in Europe and has also taken this activity in-house in Hong Kong and China. This should accelerate an already strong international performance. For example, the direct sales team in France will be able to fully exploit new disinfecting guidelines for ultrasound equipment. This market should be as big as the UK which makes it a £3m opportunity, equal to over 10% of group sales.

The big prize remains the US where Tristel is spending £0.5m pa pursuing FDA approval for its chlorine dioxide chemistry. Distribution in the US will be in partnership with the suppliers of the medical devices that Tristel's products disinfect. Unsurprisingly the approval process is taking longer than originally hoped, but once achieved a huge new avenue of growth will open up. ■

Recommendation Updates

BACK TO CONTENTS

Click here for more recommendations online at **GrowthCompany.co.uk**

DOTDIGITAL — BUY

Date recom'd	Recom'd price	Price now	Gain
Aug '16	47.5p	96p	102%

Like Tristel on the previous page, the shares have traded sideways for the last two years as the company has been growing into its lofty rating. Many growth stocks simply got too expensive during the market's bull phase, leading them into an extended period of consolidation. As with Tristel, the Dotdigital growth story is intact and the p/e of 22x is close to returning the shares to buying territory. Revenues to June grew 19%, of which 15% was organic, while operating profit was up 25% and eps 33%. Dotdigital also generates cash while growing at premium rates and the year end cash balance rose to £19m.

With a strong foundation in email marketing software, the company has added social media, chat, and mobile channels to its platform. The focus on larger clients continues to pay off with average revenue per user rising 14% to £966 per month. The quality of the business is further underpinned by the fact that 86% of revenue is recurring in nature.

Again like Tristel, the big long-term opportunity lies in overseas markets. If UK-based small caps are to continue growing, then at some point they have to develop an international arm. Dotdigital has opted to start this process organically by opening green-field offices and working with channel partners like Magento and Microsoft Dynamics. Overseas grew 28% last year and now represents 29% of group revenue. There is clearly plenty to go for and the rating on the shares no longer looks demanding. To be fair it does not look cheap either, but then there is no reason why it should. ■

Shutterstock.com

Tristel: big overseas opportunities beckon

Shutterstock.com

S&U: customer numbers picking up again

S&U — BUY

Date recom'd	Recom'd price	Price now	Gain
May '18	2,450p	2,100p	14%

Since our recommendation the market has become increasingly wary of stocks exposed to the domestic consumer. Management has reflected this caution by slowing the growth rate last year to improve the quality of its loan book. Although the shares slipped as a result, this looks to have been a prudent touch on the tiller by an experienced management team after transaction numbers had doubled over four years. S&U specialises in used car finance for customers who are regarded as sub-prime by lenders. That slowdown and consequent improvement in underwriting standards resulted in 3% profit growth in the interims to July coupled with an improvement in loan impairment rates. Customer numbers are now picking up again with a 5% increase year-to-date. There was a record number of 680,000 loan applications during the period but with the acceptance rate falling from 2.3% to 1.8% management see a "discernible improvement in debt quality".

As long as employment stays healthy S&U should avoid any major problems in the loan book. Continued growth in real wages would also ease pressures in its customer base and support a return to steady growth. The company is also developing its Aspen property bridging loan business which started in 2017 and typically lends clients £400,000 for a year secured on a house which they are developing for sale. Management requires the venture to make a £5m profit contribution on a three year view, which will require 210 deals a year in the context of 137 made to date. The p/e of 8.8x and 5.5% yield look good value. ■

Objective met

David Thornton examines the performance of the GCI Income Portfolio since August and finds that, in spite of a poor backdrop, its *raison d'être* remains intact

A poor quarter for the GCI Income Portfolio, in contrast to the strong period we reported on in August. The long-term numbers remain very positive and year-to-date the portfolio has returned 7.5%. The market has not felt great over recent months, as illustrated by the 4.5% decline in AIM in the table. Unfortunately our selections have not proved defensive during this phase, with their small-cap characteristics appearing to overwhelm any yield support.

Most investors own small-caps for capital growth and look to the blue chips for income; with the FTSE 100 being dominated by mature, dividend-paying businesses. The importance of dividends for investors in the UK equity market is illustrated by the returns of the main indices both including and excluding income. For example, the capital return of the benchmark FTSE All Share Index since we started this portfolio has been just 8.7%, compared with the 23.6% shown in the table which includes income.

The GCI Income Portfolio

	Returns to 22 Oct 2019	
	Since inception (27 Jul 2016)	Since last update (24 Jul 2019)
GCI Income Portfolio	+71.9%	-5.4%
FTSE All Share Index (total return)	+23.6%	-1.6%
AIM All Share Index	+17.7%	-4.5%

It is even more dramatic when we turn to the FTSE 100. This blue chip index stood at 6,930 on the eve of the millennium, meaning it has returned a derisory 4% in capital terms over almost 20 years. Yet when we include dividends, we find

BACK TO CONTENTS

the total return version of the FTSE 100 has delivered 113%. This still only annualises at 3.9% pa which is hardly anything to write home about; but 113% is a lot more attractive than 4%!

The point of the GCI Income Portfolio is to generate a healthy income from a selection of small caps, which should over time have superior capital and income growth prospects to their counterparts in the FTSE 100. It is still early days in the context of an equity investment time horizon; but our experience so far suggests it is a worthwhile exercise, despite this year's low-key performance.

Since inception we have generated £6,087 in dividends which equates to 25% of our starting capital. Last calendar year produced income of £1,806. We are due to receive £742 from dividends declared but not yet paid over the closing months of 2019, which when added to dividends already received of £1,923 gives a total of £2,665. This means we have increased our income by 47% this year and will have generated a yield of 6.5% on the portfolio's current value (or 11% on the starting value).

On the face of it these are good numbers and exactly what we should be doing with an income-focused brief. However I wonder whether we have slipped into trading-off future growth (in both capital and income) for a higher yield today. Our approach needs to balance these two elements and ensure that we are exposed to growing dividends, rather than high static ones.

Ironically our second weakest performer since last time has been **Bioventix** (see Digest) which has been a strong dividend grower and is due to pay another special next month. The weakest has been **XL Media**, which I suggested last time should be sold since I had disposed of it in the main Portfolio, but I lacked a ready replacement. That is pretty poor on my part and it is time to grasp a couple of nettles. XL needs to go and I will also sell **Photo-Me**. This one looks cheap with a 9% yield but dividend growth has hit a wall with the payment now barely covered.

In comes **Springfield Properties** (see Digest) on a yield of 4.4%, with the dividend increased 22% on the prior year. I am also buying **Rockrose Energy** which has indicated 85p of dividends for the current year, which provides a yield of 4.7%. Unfortunately we have missed the xd date on the first 60p of this, but I believe this stock is seriously undervalued and should generate some strong income and capital growth over coming years.

These deals will reduce our near-term income but offer more growth potential than the stocks they replace. I will also add the £1,148 of cash we have accumulated to the disposal proceeds when reinvesting.

It is hard to sell stocks like XL Media and Photo-Me which are down on their luck and trade on such big yields. However the danger is that we could end up with a portfolio of recovery stocks if we do not weed them out.

It might be OK to hold onto one or two names like that in a long list, but we cannot afford to carry passengers in a tight portfolio like this. If these shares end up cutting their dividends then we would lose on both income and capital value fronts. ■

THE GCI INCOME PORTFOLIO SUMMARY (starting capital £24,000 on 27/7/16)

Stock	Holding	Buy date	Buy price (p)	Cost (£)	Current price (p)	Value (£)	F'cast yield (%)
Bioventix*	180	27/7/16	962.5	1,741	3115	5,607	3.9
Rockrose Energy	193	22/10/19	1770	3,443	1770	3,416	4.8
Headlam	866	14/12/16	472	4,088	477.5	4,135	5.3
Diversified Gas & Oil	5,500	25/7/17	67.75	3,736	110.5	6,078	10.5
Springfield Properties	2,808	22/10/19	121.5	3,422	121.5	3,412	4.4
Strix*	3,170	29/1/18	143	3,299	172	5,452	4.7
S&U*	205	24/4/18	2490	3,713	2100	4,305	6.2
Gateley	2,840	24/7/19	162	4,601	161.5	4,587	5.3
Duke Royalty	9,800	28/11/18	44	4,302	43.5	4,273	7.1
					Cash	1	
					Total	**41,266**	

Total income received to date: £6,087

** Part profits taken or additions made*

Please do bear in mind that this is purely an exercise and does not constitute investment advice. Actual "real world" results might differ from those presented in the magazine. Individual investors should always seek personalised investment advice from a professional. The GCI income portfolio includes dividends but excludes dealing costs.

Click here to view more features online at **GrowthCompany.co.uk**

The GCI Digest

Share news, results and updates

BACK TO CONTENTS

Click here to view the very latest Insiders online at **GrowthCompany.co.uk**

The GCI Digest

BACK TO DIGEST CONTENTS

ALLIANCE PHARMA Ticker APH Sector Healthcare Market cap £369m Share price 71p BUY

Alliance is seeing good growth from its 'international stars' portfolio of healthcare products. The strategy is to acquire neglected or underexploited brands, often from companies that lack the necessary resources, and improve them. There is a bedrock of 'local brands' that generate stable cash flow, but the opportunity rests in the stars. Kelo-cote, which was acquired from Sinclair with £7m of annual sales, led the way in the latest results with revenue up 20% to £13m in the first half. Another example of a brand acquired from an owner that lacked the firepower to drive it forward is head lice shampoo Vamousse which came from TyraTech. This grew 15% to £3m in the half and can become a £10m product according to management.

A bigger product will be Nizoral which is in the process of being transferred from Johnson & Johnson. This medicated shampoo is strong in the Far East and with a better marketing focus should grow sales from the current £20m towards £30m. Xonvea, the pregnancy nausea treatment, has started more slowly than hoped with a delay in updated guidelines from the UK's specialist professional body. The prospective p/e of 13x looks too low, especially if we see upgrades on the expected 10% growth rate. ■

ANGLING DIRECT Ticker ANG Sector Retailers Market cap £40m Share price 61.5p HOLD

It is not easy to find strongly growing retailers in the current climate, but Angling Direct is having great success as it conducts a land-grab in the fishing tackle sector. Like-for-like sales grew an impressive 14.9% in the first half to July with footfall up 9.8% and basket size up 10.7% – numbers most retailers can only dream about. The store count will be 34 by the end of this year after another four stores are opened and the plan is to add ten more next year. Online is also performing strongly with UK sales up 16.8% and the conversion ratio (percentage of website visitors who make a purchase) improving further to an impressive 5.66%.

Fishing tackle retail is a fragmented sector, and this growth comes from offering an authoritative range of products sold in large modern stores of around 4,000 square feet. Falling rents means Angling Direct can now afford to take space on some retail parks with the roll-out from here being mainly organic. A warehouse in Europe is likely soon to service a developing online business on the continent. Trading in August and September has remained positive. Investing in expansion means the company is hovering around breakeven but the prospective market cap:sales ratio of 0.6x looks attractive. ■

ANIMALCARE Ticker ANCR Sector Healthcare Market cap £99m Share price 165p HOLD

Animalcare is recovering from the disastrous reverse takeover of Ecuphar in 2017. Jenny Winter took over as CEO a year ago and has initiated an integration process, which had been neglected in the aftermath of the deal, and is rationalising the product portfolio where there is a tail of unprofitable lines.

The company will focus on companion animals and equine, with the antibiotics business in production animals continuing to decline. New products are coming through as planned but it will take a couple of years before larger, higher margin products are introduced. The supply chain is also receiving management attention, with disruption causing a significant loss of sales for an anaesthetic product in the UK during the latest reporting period.

Winter told *GCI* that the business is now properly aligned with people now in the right places; so it should be more 'business as usual' from here after a period of disruption. The shares dipped to a low of 115p back in April but have recovered and have broadly tracked sideways over the last year. Veterinary medicine stocks tend to command premium ratings, so the current 14.6x looks reasonable. However it might take another year or two before the company returns to a growth path. ■

The GCI Digest

BACK TO DIGEST CONTENTS

BIOVENTIX Ticker BVXP Sector Healthcare Market cap £180m Share price 3,400p **HOLD**

This member of the *GCI* portfolio is up 60% since we tipped it in March last year. Results for the year to June were as expected and the shares are unsurprisingly consolidating given a p/e in the high 20s. Revenue growth was 16% on a like-for-like basis with eps up 15%. This is a good performance from a high quality business but does not maintain a record of positive surprises and upgrades which drove the solid uptrend in the shares to the peak of £40 in May. The main driver continues to be antibodies for vitamin D deficiency testing where sales grew 27%. Management say that this product continues to surpass expectations. While there is evidence of sales values starting to plateau in the US and Europe with lower prices offsetting growth in volumes, newer markets in Asia should continue to move sales forward.

The next leg of growth rests on the success of the high-sensitivity troponin test for heart attack. The first revenues of £120,000 were booked during the period with the test in its early stages of being rolled-out by Siemens and management "…has no reason to question our belief that these assays will generate significant value into the future". There is another special dividend which puts the shares on a 3.5% yield. Happy to buy on weakness. ■

BLANCCO Ticker BLTG Sector Software Market cap £96m Share price 129p **BUY**

Blancco provides software that erases data, allowing corporate customers to comply with regulations like GDPR and ensure the security of their data on IT devices. The company is focused on three market segments: Enterprise, Mobile and slower growing IT asset disposal. Mobile is a large, growth market where Blancco's software allows device owners to realise the value in their old phones by trading them in with confidence that their data will be properly wiped clean. Customers are the carriers, third-party logistics companies who handle refurbishments, and phone retailers. The other focus of growth is the Enterprise market where Blancco is initially targeting data centres. This tends to be driven by regulation with a need to manage and control the exponential growth in data. Blancco allows hardware to be recycled and the process to be automated and certified compliant with regulations. The company is moving away from direct sales towards a focus on channel partners for distribution.

Sales grew 12% in the year to June and have scope to accelerate from this level. And as a software business with 95% gross margins there should be increasing returns to scale. A £10m placing in July to cover the cost of an acquisition also raised enough cash to leave a flat net debt position. ■

CAPITAL DRILLING Ticker CAPD Sector Resources Market cap £85m Share price 62.5p **BUY**

The company provides drilling services to mining companies in nine African countries. There is a bias to mining operations rather than short-term exploration contracts with 80% of revenues coming from mineside contracts, which typically offer 3-5 year deals or longer if the relationship is strong. For example, Capital has been at Centamin's Sukari gold mine for over ten years. With the gold price strengthening, exploration demand is increasing which should tighten utilisation rates and pricing. The industry has been starved of capital for years but things seem to be picking up and CEO Jamie Boynton said Capital has its best ever pipeline of projects.

Boynton stepped up to the role in 2017 and has reduced the head office overhead after the business had become too centrilised. Last year the company entered West Africa which is a big province accounting for almost half of African mining sector spend. A significant new contract with Allied Gold in Côte d'Ivoire also broadens Capital's offering into load and haul provision, which is a larger market than drilling. The shares have been on a roller coaster since IPO in 2010, with a good debut followed by a steep decline as the gold price fell. The chart looks very encouraging again and the stock trades on a p/e of 10x with net cash in the balance sheet. ■

The GCI Digest

BACK TO DIGEST CONTENTS

DEKELOIL Ticker DKL Sector Food Producers Market cap £8m Share price 2p SPECULATIVE BUY

Dekel shares have fallen 80% over the last couple of years to a level where they have speculative attractions as a deep value play. The company buys raw palm fruit from farmers in Côte d'Ivoire and processes it into crude palm oil at its mill. Last year it was hit by low volumes due to a poor harvest combined with a depressed commodity price. Dekel is a processor, so is less sensitive to palm oil prices than a plantation owner would be; but low prices have still had a negative effect. The market price now seems to be recovering and stands at $550 per ton compared with a 10 year average of $800 and Dekel's first half production this year was 30% up on 2018's depressed level, suggesting a more normal harvest.

There are diversification plans, with a move into cashew nut processing expected to be ready for the full 2021 season. Côte d'Ivoire is undersupplied in mechanised processing capacity with the traditional approach being labour intensive, resulting in raw nuts being exported rather than adding value to them locally. The initial plant capacity of 10,000 tons could generate revenue of $20m. Two years ago the company had eps of € 0.5 cents and paid a 0.17 cent dividend. Broker forecasts for next year have the stock on a p/e of 2.5x and a yield of 8%. ■

EQUALS Ticker EQLS Sector Financial Services Market cap £160m Share price 90p BUY

Equals is the new name for FairFX, the need to re-brand reflecting its transition from a foreign exchange specialist into a provider of a broad range of banking services. We tipped the shares at 59p in June 2017 and the stock hit 150p a year ago but has since slumped. Profit forecasts published in 2018 for the current year and next have turned out to be far too optimistic; but assuming the numbers are now soundly based, the shares look good value again on a 2020 p/e of 10.7x. We spoke to CEO Ian Stafford-Taylor after the interims who said he was comfortable with forecasts and that revenue is on track.

It is probably wrong to focus too much on near term profitability because the company is still building out its product range and focusing on growing its SME customer base. Banking services for the SME sector offer notoriously poor value and incumbents rely heavily on inertia to keep customers. Equals' expenses software service is a free feature which allows employers to manage spending on corporate cards and provides an effective gateway into new customers. New services have been added including international payments and a brokered loan product. £14m was raised in August at 110p which provides scope for further bolt-on acquisitions. ■

KEYSTONE LAW Ticker KEYS Sector Support Services Market cap £147m Share price 470p HOLD

Keystone's p/e multiple of over 30x is 2-3x that of quoted peers. There is a good reason for that and the business model is an attractive one, as we pointed out when recommending the stock at 303p in June 2018. The company provides a brand and operating platform for experienced, entrepreneurial lawyers who want to focus on client work rather than managing a law firm. Lawyers retain 70% of the fees they generate and get all the support and infrastructure they would have in a conventional firm. Headcount growth is an important driver of revenue and the recruitment pipeline remains strong. Keystone encourages 'pods' of mini law firms to develop under its umbrella which have scope to attract larger and more sophisticated clients. This gives scope to increase the average fees generated per lawyer, currently £150,000.

Management has a 'mid-term' target of 15% operating margins, compared to the current 11%. This depends on either reducing marginal costs (ie generating a platform effect) or increasing average revenue per lawyer. The senior management team is the main element of fixed costs, with new lawyers requiring additional support staff. Confidence in that margin target would justify buying; but meanwhile the rating will likely restrain progress. ■

View more *Growth Company Investor* recommendations, including thousands in our extensive archives, on the website:

www.growthcompany.co.uk

The GCI Digest

BACK TO DIGEST CONTENTS

MIDWICH Ticker MIDW Sector Support Services Market cap £411m Share price 514p BUY

The value-added distributor of specialist audio visual equipment has doubled since our recommendation three years ago; but like many growth stocks it has had a difficult 12 months. The stock hit a high of 680p this time last year and since then we have had a few upgrades; so there has been a meaningful derating. The current year p/e of 16.3x falls to 14.7x next, which combined with a 3% yield makes the shares look attractive.

Midwich has continued to earn a high gross margin for a distributor of 16.6% in the latest period. This reflects its technical input and the fact that it is the sole or largest distributor for most brand owners in the countries it operates in.

Europe was the strongest region so far this year with organic growth of 14%, boosted to 47% by acquisitions. Prior year acquisitions have been integrated and are performing well, while three deals in the first half brought Switzerland, Italy and Norway into the group as new territories. The deal pipeline is said to be "strong". Net debt is forecast to end the year around £50m in the context of £40m ebitda, so leverage looks comfortable with management willing to gear up to 2x. ■

NORTHBRIDGE INDUSTRIAL SERVICES Ticker NBI Sector Industrials Market cap £34m Share price 121p BUY

We recommended Northbridge in June on the basis that the company was turning round after a lengthy downturn. Unfortunately our timing has been off, even though the fundamentals appear to be on track. The interims saw the first reported profit since 2014, supported by improving conditions in the drilling tools market. This division is seeing a "patchy recovery" but the trend seems to have turned upwards with Australian gas and LNG being strong points. Market share has improved significantly as the company maintained its customer relationships during the lengthy downturn. As utilisation rates pick up we should see prices improve and operational gearing effects come through. Revenue at Tasman in the half was up 29% and over double that recorded two years ago. Crestchic loadbanks is also seeing a pick up in oil and gas sector projects. Growth is continuing in European data centre power supplies. This division rents and manufactures for sale, with the latter having a particularly good first half.

Net debt is forecast to end this year at £5.6m and fall substantially in 2020 as profitability improves further, while the balance sheet carries £29m of tangible assets. Next year's operating margin is forecast to be 8.6% by brokers; the company has historically earned close to 20%. ■

RBG HOLDINGS Ticker RBGP Sector Support Services Market cap £85m Share price 99p BUY

RBG is the new name for litigation law firm Rosenblatt and reflects its diversification into corporate finance through the acquisition of Convex. This business is based in Manchester and typically helps owner-managed businesses realise their value by arranging their sale to larger corporates. Convex has a similar entrepreneurial culture to Rosenblatt and earns success fees rather than retainers. RBG knows the business well, having acted for its clients in around 20% of Convex's deals. There should be a quick win from cross-selling legal services to all Convex clients going forward. Convex will also reduce reliance on litigation, currently 80% of revenues.

The core litigation business saw £2m revenue recognised in the first half from the sale of an interest in a case that RBG is funding.

The shares were unsettled by the publicity surrounding Burford Capital which shone a spotlight on the sometimes opaque nature of litigation funding. However this activity has potential to generate significant value for shareholders: given RBG's expertise as a practitioner it should be uniquely placed to make investments in winning cases and unlike Burford it does not use fair value accounting. Prospective p/e 11.6x and 5% yield. ■

View more *Growth Company Investor* recommendations, including thousands in our extensive archives, on the website:

www.growthcompany.co.uk

The GCI Digest

BACK TO DIGEST CONTENTS

SIGMA ROC Ticker SRC Sector Construction & Materials Market cap £122m Share price 48p **BUY**

This acquisitive building materials company was tipped in January 2018 at 42p and the shares remained stuck around that level for most of the following period. We spoke to management following the recent interim results which confirmed the strategy is on track. The aim is to copy Breedon's success in consolidating a network of related businesses within a fragmented and localised industry. Starting from a base in the Channel Islands the company has expanded into England and South Wales with quarrying and fabricated concrete products. More recently it acquired Stone in Belgium on a 4.4x ebitda multiple. Stone is close to CEO Max Vermolen's birthplace, so the region is well known to management and is the key supplier of stone to Benelux and Northern France.

The Stone deal has just been followed up by the larger acquisition of CDH, a Belgian blue limestone and aggregates business. The €45m purchase price has been funded by a £33m placing at 41p and comes on a more expensive 6.8x ebitda multiple, however it is expected to enhance eps by a double-digit percentage. Having been somewhat moribund the shares sparked into life on this news and the boost to the market cap should put the stock on the radar of more investors. Good value on a sub-10x p/e. ■

SPRINGFIELD PROPERTIES Ticker SPR Sector Home Construction Market cap £118m Share price 122p **BUY**

Scotland-based Springfield has grown impressively since its IPO two years ago, helped by a couple of acquisitions which have expanded its regional exposure. Earnings grew 30% over the year to May and should rise a further 11% in the current period. The Scottish market has been more stable than England and Wales of late, with prices continuing to rise by 4-5%. The majority of the business is private housing which operated from 29 developments, with 14 new sites added last year. Five sites are new self-contained villages which will be built out over several years. Overall the land bank grew 28% to 16,000 plots.

Springfield earns around 20% of its profits from social housing which provides good visibility and a steady revenue stream. The Scottish government has demanding targets for affordable housing and a supportive framework for the planning process. Springfield acquires suitable sites and sells the land to a local authority or housing association partner once it has consent, then receives monthly progress payments as the project is built. Further growth and visibility should come from a move into the private rented sector via a partnership with Sigma. The shares have bounced recently but remain good value on a p/e of 8x and 4.4% yield. ■

ZOTEFOAMS Ticker ZTF Sector Chemicals Market cap £151m Share price 313p **HOLD/BUY**

Our recommendation in September was badly timed with the company warning on profits this month following weak demand for its polyolefin foams. We noted a slowdown in automotive demand in our article but the general European market has seen "significant deterioration" recently. The board states that divisional sales will be £6m below estimates and high operational gearing means this year's profit forecasts will take a hit of around 30%, with eps now expected to be in the region of 15p.

Zotefoams was recommended because it is a quality company with an attractive organic growth opportunity in its High Performance Products division (HPP). It had been on our radar for a while but, as we remarked, "…like many quality stocks, the shares had got too expensive to buy"; unfortunately our comment that they were "now looking more interesting" has proved distinctly premature. The main issue now is how long this slowdown lasts and how well the cost base is managed. The company has taken on debt to expand capacity in HPP; so this also needs to be watched – the leverage ratio rises to 2.2x on the revised ebitda number. A forecast recovery next year gives an attractive p/e of 17x; but we should wait for reassurance that things have stabilised before buying. ■

View more *Growth Company Investor* recommendations, including thousands in our extensive archives, on the website:

www.growthcompany.co.uk

BACK TO CONTENTS

Market Outlook

David Thornton believes there is value in small caps for those prepared to take a long term view

Another lacklustre month for UK equities. It is hard to discern any clear-cut trends at the moment, though many domestic-focused stocks have picked up of late (the top 5 performers in the FTSE 100 over the last month have been BT, Land Secs, Next, United Utilities and Royal Bank of Scotland). This might be down to hopes of a Brexit settlement which has also seen a rally in sterling; or it might just be noise while we wait for clear leadership to emerge.

A liquid picture

Looking at the table we can see that the FTSE Mid 250 index has recovered much better from last year's fourth quarter bear market than its Small Cap and AIM counterparts.

AIM in particular is still digesting the derating of its large, high p/e, growth stocks. The Mid Cap index also saw a bounce of 4% on 11 October 2019 in response to Brexit hopes. This is an impressive single day move and reflects the fact that mid caps provide a liquid way to play UK domestics. The key word here is "liquid".

FTSE Small Caps and AIM have not reacted much to this interest in domestics further up the size scale. That might be partly due to AIM's growth stock make-up as mentioned; but it might also reflect liquidity risk. Liquidity in small caps has been drying up over time with regulatory changes like Mifid II serving to make things worse.

"The Woodford scandal looks like it will make neglect of small caps worse... A broking friend tells me that risk managers now have the upper hand, standing over fund managers' shoulders and querying their exposure to small caps and less-liquid stocks"

The Woodford effect

If you commit to small caps as an institutional investor you have to mean it and be prepared to stick with it for the long run, because the chances are you will struggle to get out in a hurry. This means that our market will move a long way

CAPITAL RETURNS TO 23 OCTOBER 2019

	AIM	FTSE SmallCap	FTSE Mid-250	FTSE 100
1 month	0.1	-1.0	0.7	-0.9
1 year	-9.4	-0.2	10.0	4.4
3 years	7.1	8.9	12.5	3.4

once it gets going; but it might have to endure long periods of neglect.

The Woodford scandal looks like it will make this neglect of small caps worse. Woodford imploded due to his heavy investments in unquoteds which were completely illiquid (and a load of rubbish in many cases); but the scandal has focused minds on how long it would take for a fund to raise cash and sell down its equity exposure. A broking friend tells me that risk managers now have the upper hand, standing over fund managers' shoulders and querying their exposure to small caps and less-liquid stocks.

A long view

Of course this is not altogether bad news for us if we are prepared to take a long view. Small caps already offer good value in many cases with the recent upswing in takeover activity endorsing that view.

Less involvement from brokers and institutions will create further inefficiencies and opportunity for those who make the effort to do the research and are willing to put up with the illiquidity.

As private investors, liquidity is not much of an issue since most of us deal in small lots and we do not have to obsess about our monthly or quarterly performance figures. Which gives us a significant advantage; but also highlights the need for patience in our decision making. ■

BACK TO CONTENTS

The GCI Portfolio

The demise of Thomas Cook provides a boost for one of our holdings

A reasonable month last time has been followed by a slightly disappointing one. My impression is that this is a rather directionless market with few clear trends, if any.

Our main detractor over the month was **Bioventix** which cost us 1.2%. As discussed in the Digest, the results were fine but not enough to trigger upgrades and with a p/e in the high 20s there has been an understandable bout of profit taking. We did some of that ourselves back in February at the 3,485p level but are happy holding on to what remains a very high quality, cash generative, growth stock. The special dividend means the shares are about to go ex a 90p payout which is a near 3% yield on the current share price of 3160p. At that level the shares are on a current year p/e of 25x to June 2020, falling to 23x the following year. This is close to buying territory; so I am happy to hold firmly onto our position.

Our other double-digit faller was **TT Electronics** which inexplicably fell 12% and cost the portfolio 1%. So these two stocks explain our underperformance relative to the market over the month. Interim results in August were well received and saw the shares move up from 215p to 260p in late September, only for the move to largely unwind. Maybe next time we will get the chart breakout following what has been a consolidation pattern lasting over two years. The stock trades on a prospective p/e of 11x and yields over 3%, making it a prime example of the value available in small caps and, as we conclude in the Outlook, we have to exercise patience.

RockRose surrendered some of last month's gains but also went ex a 60p dividend which has not yet been received. This is our largest position with a 10% weighting and I am happy for it to remain so.

Our best performer, up 10%, was **On the Beach** which continues to recover from the profit warning in August. This was related to sterling's weakness putting it at a disadvantage against tour operators who had hedged their inventory earlier in the year. This effect should be transitory and the company's competitive position has now been boosted by the failure of Thomas Cook. Management see this as "an unprecedented opportunity to take additional market share". Hopefully this means we are at the start of a new uptrend for the stock.

While still tempted to freshen up the list with a new holding, I note that his year we have introduced Manolete, Rockrose, Vp and Codemasters; so we have not been idle. Four new names in a 14 stock list represents a reasonable amount of interference from the portfolio manager. ■

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

RETURNS TO 23 OCTOBER 2019

	Since last month	Since inception (20/10/15)
GCI Portfolio	-2.2%	+118.0%
FTSE All Share Index (total return)	0.1%	+34.8%
AIM All Share Index	0.6%	+18.9%

PORTFOLIO SUMMARY (starting capital £60,000 on 20/10/15)

Stock	Holding	Purchase date	Purchase price (p)	Purchase cost (£)*	Current price (p)	Current value (£)
Victoria	1,835	15/12/15†	236	4,289	480	8,808
Somero	2,400	26/1/16†	136	3,278	198.5	4,764
IG Design	1,698	26/1/16†	162	2,764	620	10,528
On the Beach	2159	20/5/16†	296	6153	451	9,737
Tremor Intl.	5,229	22/8/16†	160.5	8,451	148.5	7,765
Mission Marketing	13,666	26/4/17†	42	5,756	84.5	11,548
Vitec	727	21/2/18	1135	8,047	1272.5	9,251
Bioventix	316	21/2/18†	2140	6,779	3160	9,986
IMImobile	2,868	24/7/19	316	9,073	307.5	8,819
Rockrose Energy	739	21/2/19	760	5,654	1770	13,080
TT Electronics	4,575	31/10/18	212	9,709	221	10,111
Manolete Partners	2,166	21/2/19	301	6,530	440	9,530
Vp Group	920	27/6/19	870	8,054	850	7,820
Codemasters	3,676	27/6/19	224	8,244	215	7,903
					Cash	871
					Total	**130,521**

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

BACK TO CONTENTS

The investor's investor

In the second part of Scott Longley's interview with US-based Australian entrepreneur John Bailye, he shares a little secret "lost to almost every private equity company"

John Bailye is a great believer in the Peter Principle – stating that employees tend to rise to "their level of incompetence" – and it is his belief that in the US business founders tend to be much more dispassionate about replacing even long-standing employees if they do not look likely to step up to the next level.

The value of having detachment, whether that is around hiring and firing decisions or investment in infrastructure, is something he came across by accident but which now is central to his business philosophy.

"The secret to survival was that you had to detach value from things that had been important in the past. The more you have tentacles holding those in, the more likely you were not to make a change and then that was the start of the end."

The customer is key

Translating this to the venture capitalist (VC) realm, he said "the fund's interest is not the entrepreneur", it is the business and how that business can best be supported regardless of personnel.

"If you are a VC of any sort, your job is to ram as much money in as early as you can and just hope that one works because you own enough of it now that it will carry the fund," he said.

In fact, the key person with any business, he added, is the customer.

"The customer had always been, for me, at the centre of any value created.

"When a company is going through these early stages of growth and survival it means that you have found somebody who will buy what you are doing, but the next person who comes along might want something different so you have got to be able to change it, modify it and improve it," he said.

"Your business is totally centred around your product.

"If you have been in business and you have got to make payroll, then the only way you are going to make payroll is because the customer buys what you are selling," he added.

"That little secret is lost to almost every private equity company I have ever been to."

Nurture and nature

Without mentioning a name, Bailye says he was helped when in New Jersey by an investor who, when he got involved, joined the board because, as Bailye put it, "he knew my foibles".

"That turns out to be pretty important for anybody that the entrepreneur is actually going to listen to: the first box to tick is does he know me? Does he accept me for what I am?"

He said that at board meetings he was "kind of the adult in the room".

"He taught me about planning the next [funding] round before I priced this round. He taught me a few things that are intrinsic in successfully funding companies today and of course there was no manual."

Though Bailye himself opted for New Jersey for his business, he does have a view on why Silicon Valley has been the standout hotbed of tech entrepreneurship.

Pointing to the calibre of people that have come out of Stanford University – the founders of Instagram and Snapchat as well as LinkedIn, PayPal, Netflix and, of course, both Sergey Brin and Larry Page from Google – he said it is a philosophy to forming businesses that provides the key difference.

"The philosophy of Stanford was always nurture businesses close to ground and keep nurturing and nurturing."

The eight companies that the Side by Side Partnership are already invested in for the EIS fund will be hoping for the same hand-holding treatment. ■

John Bailye, Side by Side Partnership

Click here for more fund manager interviews on **GrowthCompany.co.uk**

BACK TO CONTENTS

AIM Newcomers

Company	Sector	Adviser	Type of issue	First dealings	Market cap (£m)	Issue price (p)	Funds raised (£m)
Entertainment AI	Media	WH Ireland	Transfer from main market	30/9/19	23.7	45p	8.6

Click here for more AIM Newcomers on **GrowthCompany.co.uk**

AIM Movers – 1 month to 23 October

AIM 100 index

Risers	%
Smart Metering Systems	48.8
Dart Group	41.5
ASOS	36.5
AlphaFX	28.4
Bushveld Minerals	27.1

Fallers	%
Premier African Minerals	354.4
Yolo Leisure and Technology	261.7
Vast Resources	183.3
Stilo International	100.0
Scotgold Resources	88.3

AIM All-Share index

Risers	%
WANdisco	-27.7
Blue Prism	-21.5
Accesso Technology	-21.1
Clinigen	-16.7
Eco (Atlantic) Oil & Gas	-15.1

Fallers	%
Motif Bio	-73.9
Hydrodec	-71.4
Great Western Mining	-61.1
Thor Mining	-60.0
Zibao Metals Recycling	-55.5

Click here for more AIM Movers on **GrowthCompany.co.uk**