Canaccord Genuity Wealth Management

INTELLIGENT INVESTING

February 2024

Market review

The economic markets' Christmas party was undoubtedly a good one. But is 2024 kicking off with a New Year hangover?

Since the end of 2023, bonds are down, equities are down (with a couple of major exceptions – see below), oil is down and copper is down. It's been a sobering wake-up call after the exuberance of November and December last year.

Back then, following better-than-expected inflation figures in the US, Europe and the UK at the end of October, previously gloom-laden investors performed an abrupt pivot, driving bond yields down and equities up. Multiple central bank interest rate cuts were factored in, and with valuations cheap across many asset classes, markets soared.

Now, quite suddenly, the boot is on the other foot. With signs of widening conflict in the Middle East, a lurch backwards in terms of inflation data and still-hawkish-sounding central bankers, the pivot seems to be going the other way.

So, where do we stand going forward? Firstly, we must acknowledge that US and Japanese equities have continued to motor. In the former, still-robust economic data and momentum behind the technology titans have kept things ticking over. In the latter, decent valuations and a weaker currency have trumped worries over anemic Chinese growth. Through the lens of the UK, it feels like we're in reverse, but this isn't the case with a global hat on.

In fact, we believe this is a typical wobble after two months of overexcited markets. We still think that inflation is coming down over the next few months, and never believed we'd see the number of interest rate cuts that the more hyper investors seemed to imagine possible. The next move is indeed down in our opinion, and that's what we need to focus on. That, and the plentiful availability of keenly priced stocks.

In this issue we look at Barclays, our favoured UK bank stock, which has a 12-month forward price-to-earnings ratio (P/E)* of 4.6x and a prospective dividend yield* of 6.4%. We also shine a light on Telecom Plus, a utility service company with a dividend yield of almost 6% and a P/E of 13.4x, the lowest since 2011. In the US, we turn our attention to Otis Worldwide, the lift manufacturer which enjoys strong recurring revenues and sits on a free cash flow yield of more than 5%.

Value is out there, and it's widespread. If we're right about the trajectory of inflation and interest rates throughout 2024, there's a decent chance that both equities and bonds can go up again, and we'll be back in a positive environment for investors. And that's despite political uncertainty, of which we expect plenty to come this year.

Richard Champion
Co-Chief Investment Officer

*See glossary for definition.

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UK LARGE CAPS

Many happy returns

The big three domestic banks (Lloyds Bank plc, Barclays plc and National Westminster Bank plc) generated £80bn of profit from 2010-2020. Despite this, it was a lost decade for shareholder returns due to numerous headwinds. These include £55bn of litigation and conduct costs (of which the majority was PPI), as well as restructuring, pension contributions, extra software spending and reductions in equity capital due to the 2014 introduction of Basel III legislation. Factoring in the net issuance of new shares, shareholders effectively received no distributions from 2010-2020.

However, 2021 marked a turning point, with these banks returning over £6bn to shareholders. The pace of capital returns has since accelerated, with more than £20bn returned in 2022 and 2023 combined. With balance sheets in rude health, we expect another year of strong shareholder capital distributions in 2024. Given the current £71bn market value of these four banks, if they were to continue to distribute £10bn each year, it would equate to an annual shareholder capital return of c.14%.

We see these returns as sustainable, largely because litigation, conduct and restructuring peaked a few years ago; actuarial pension deficits, which peaked at £20bn in 2016, have fallen sharply; and regulatory spend headwinds have mostly abated.

Of these three banks, we believe Barclays offers the greatest share price upside, given the highly depressed multiples at which it trades (2024e P/E* of 4.9x and price to tangible book value* of 0.47x) relative to its peers. In the first nine months of 2023, it delivered a Return on Tangible Equity (RoTE)* of 12.5%, which compares favourably to our estimated cost of capital of c.10%. Our rule of thumb with bank valuations is to assume a bank should trade on a price to tangible book ratio equivalent to its RoTE, divided by its cost of equity. Assuming a RoTE of 10% going forward, this suggests Barclays should trade on 1x price to tangible book, or 316p per share – more than double the current share price.

Barclays plc

Share price	148p
Market cap	£22.5bn

	2022A	2023F	2024F
Price Earnings Ratio	4.0	5.1	4.9
Earnings per Share (p)	40.7	30.1	30.1
Dividend per Share (p)	7.2	8.5	9.0
Dividend Yield	4.4%	5.5%	6.1%
Bad Debt %	0.3%		
Return on Equity	12.1%	7.9%	7.4%
Loans & Advances (£bn)	392		
Financial year end*			31 December

Source: Quest®
Note: 2023 and 2024 are forecast years

We aren't suggesting Barclays will double overnight, but over time we expect to see this discount gradually narrowing. The cherry on the cake is Barclays' balance sheet, with a Q3 Common Equity Tier 1 (CET1)* ratio of 14%, half a percentage point above the middle of its 13-14% range. This means it could return £1.7bn (7.6% of market cap) to shareholders and still remain in the middle of the desired capital range.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

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UK SMALL CAPS

Positive energy

Telecom Plus plc (Telecom Plus), which trades as Utility Warehouse (UW), supplies utility services (energy, broadband, mobile and insurance) in one monthly bill, making things simpler for customers. It was founded over 25 years ago and is now the UK's seventh-largest energy provider, supplying over 900,000 households and businesses.

Unlike other utility suppliers, Telecom Plus acts as a discount club. The lowest prices and most attractive benefits are reserved for members who switch all their services (energy, broadband, mobile and insurance) to its products.

Telecom Plus relies on word-of-mouth recommendation to increase its market share. It has a growing community of 45,000 UW 'partners' who can earn money in their own time by recommending Telecom Plus services to people they know. This, combined with fair pricing and good customer service, contributes to very low customer churn rates.

The company derives operating efficiencies relative to its competitors by spreading a single set of overheads across the multiple individual service-related revenue streams. This provides cost benefits that help it price competitively. It also has a long-standing supply relationship with E.ON UK plc, under which the latter assumes the substantive risks and rewards of buying and hedging energy for customers.

Telecom Plus has delivered uninterrupted growth in customer numbers for every one of its 25+ years, which in the six months to September 2023 was running at an annualised +14%. There are some risks in relation to regulatory changes and the macro environment but following the collapse of much of the competition, it has scope to grow its customer base faster, and to start benefitting from operational leverage.

Telecom Plus plc

Share price	£14.54
Market cap	£1.1bn

	2023A	2024F	2025F
Revenue (£bn)	2.5	2.1	2.2
Earnings per share (p)	82.9	105.1	117.3
Dividend per share (p)	80.0	84.4	88.5
Dividend yield	4.1%	5.8%	6.1%
Free cash flow yield	14.3%	9.3%	10.3%
Price earnings ratio	23.7	13.8	12.4
Return on capital employed	67.5%	77.8%	77.3%
Financial year end*			31 March

Source: Quest®
Note: 2024 and 2025 are forecast years

The shares trade on a forward next-twelve-months P/E* of 12.6x (versus a five-year average of 29.5x) with a dividend yield of 6%.

Ian Berry
UK Small Cap Equity Analyst

*See glossary for definition.

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Investments in smaller companies are not suitable for all investors as they are high risk and tend to be more volatile and illiquid. Selling may be difficult and they can fall further than the wider market. They are more exposed to fluctuations in the domestic economy and growth is not guaranteed. When we talk about investing in smaller companies, we typically mean companies listed on AIM or those with a market capitalisation of less than £1bn, which are not within the FTSE 100.

UK EQUITY SCREEN

Buyback bargains?

Many UK public limited companies (plcs) continue to be materially undervalued and potential targets of private equity and corporate mergers and acquisitions (M&A). But there is a strong argument for companies to resist opportunistic M&A and buy their own stock instead.

Using Quest® - our proprietary equity valuation tool with 18,000 stocks under coverage - we have found that there are several companies sitting on large cash piles, making the balance sheet inefficient. This could be deployed more efficiently to buy back undervalued shares and potentially improve share price performance.

The obvious question to pose is whether buybacks lead to share price outperformance. Academic literature definitively says 'yes', with Ikenberry et al. (1995) finding that for 1,239 publicly announced share buybacks between 1980 and 1990, the average on-the-day outperformance was 3.5%. However, this increased to 12.1% by adopting a four-year buy-and-hold basis. But by far the most interesting part of this research is that, for the stocks they classified as materially undervalued, the four-year outperformance increased to an impressive 45.3%!

With this in mind, we've used Quest® to screen for companies which satisfy the following criteria:

- Held at least 10% of their market value in cash at the end of their last financial year
- Have reduced the number of shares in issue by at least 1% over the last three years
- Rank in the top quartile of the 1,050-stock Quest® UK universe using Quest's® triangle valuation measure*.

Simon McGarry
Head of Direct Equity Research

*An aggregate valuation score using five uncorrelated conventional and proprietary metrics.

									Price change over		
Stocks	**Industry**	**Market value (£m)**	**Cash/ market value**	**Change in shares in issue over 3-years**	**triAngle value score 1 = Worst 33 = Best**	**Price earnings ratio**	**Dividend yield**	**Dividend cover**	**1mth**	**3mths**	**12mths**
Shell	Oil gas and consumable fuels	158,952	21%	-16%	21	7.7	4.5%	2.8	-5%	-8%	3%
BP	Oil gas and consumable fuels	77,753	28%	-17%	23	6.9	5.1%	2.7	-1%	-8%	-5%
Tesco	Consumer staples distribution and retail	20,045	11%	-9%	22	11.3	4.4%	2.0	-1%	6%	17%
Whitbread	Hotels restaurants and leisure	6,645	19%	-8%	21	15.6	2.9%	2.3	-2%	8%	18%
Abrdn	Capital markets	3,001	31%	-16%	23	14.5	8.7%	0.8	-6%	8%	-21%
Johnson Matthey	Chemicals	2,976	18%	-5%	24	9.5	4.9%	2.2	-4%	9%	-28%
Harbour Energy	Oil gas and consumable fuels	2,148	16%	-17%	30	4.8	7.4%	1.9	-10%	10%	-11%
Balfour Beatty	Construction and engineering	1,770	60%	-22%	23	8.8	3.6%	3.1	0%	7%	-9%
FirstGroup	Ground transportation	1,072	111%	-47%	29	10.6	3.4%	2.9	-4%	7%	56%
Greencore	Food products	477	32%	-11%	25	10.4	2.5%	3.9	6%	14%	28%
Kenmare Resources	Metals and mining	282	22%	-19%	32	5.2	7.0%	2.9	-20%	-20%	-33%
DFS Furniture	Specialty retail	266	11%	-10%	23	8.6	4.9%	2.4	-5%	12%	-23%
Galliford Try	Construction and engineering	245	112%	-10%	21	10.8	5.5%	1.9	10%	14%	46%
Vertu Motors	Specialty retail	220	38%	-8%	22	7.3	3.6%	4.2	-7%	-13%	11%

Source: Quest®

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Past performance and future forecast figures are not a reliable indicator of future results.

US EQUITIES

Elevated success

Otis Worldwide Corp. (Otis) is the world's leading elevator and escalator company, designing, manufacturing, installing and servicing products across over 200 countries globally. It is split into two main sectors: new equipment sales and services.

The first arm oversees elevator and escalator installation in residential, commercial and industrial buildings. The percentage of the global population living in urban areas is expected to increase from 55% in 2020 to 60% in 2030, which is driving demand for high-rise residential buildings and therefore elevators – particularly in the Asia-Pacific region, which is anticipated to contribute nearly 75% of global new equipment sales.

The other, more defensive (and attractive), principal sector is services. Approximately 80% of service revenue comes from recurring maintenance and repair contracts. Maintenance contracts benefit from strong regulatory support, given the requirement for regular checks and repairs on installations to meet safety standards.

Moreover, in taller structures, building operators aim to minimise disruption and inconvenience caused by breakdowns by ensuring equipment is frequently assessed.

Additional service revenue is generated from modernisation or upgrading older systems. Ageing infrastructure is the primary growth driver of modernisation, with more than half of elevators and escalators in operation in North America and Europe being over 20 years old.

Technological advancements are also making Otis' business model more defensive. The maintenance industry for elevators and escalators is highly fragmented, with many independent service contracts. However, Otis has developed the Otis ONE digital platform, which collects and analyses large amounts of data through smart sensors. This enables the company to detect potential issues earlier, minimising downtime and, in some cases, fixing the issue remotely. The technology is making it harder for independent service companies to win maintenance contracts, thus increasing Otis' market share. Currently, around one third of Otis units use this smart connected technology, with plans to increase this to 60% in the medium term.

The service sector is Otis' more profitable arm, generating operating margins of more than 20%, compared with new equipment sale margins of closer to 6%. Furthermore, while service revenues contribute to 60% of total sales, they generate 80% of operating profit.

In summary, Otis is an appealing investment, supported by advancements in technology, an ageing infrastructure of stock, and a global trend of increasingly urban populations.

Dan Smith CFA
International Equity Analyst

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Otis Worldwide Corp.

Share price	US$88.4
Market cap	US$36.2bn

	2022A	2023F	2024F
Revenue (US$bn)	13.7	14.1	14.6
Earnings per share (US$)	3.1	3.5	3.8
Dividend per share (US$)	1.1	1.3	1.4
Dividend yield	1.5%	1.5%	1.6%
Free cash flow yield	4.1%	5.0%	5.1%
Price earnings ratio	24.2	24.0	23.1
Return on capital employed	155.6%	184.5%	201.8%
Financial year end*			31 December

Source: Quest®
Note: 2023 and 2024 are forecast years

These figures above are shown in US dollars (US$). These returns may differ significantly when converted to other currencies at the prevailing exchange rates.

INVESTMENT TRUSTS

Rising in the East

For all the doom and gloom around China, which we take very seriously, we continue to believe that ample opportunities are on offer across Asia. World-leading companies exist here, such as Taiwan Semiconductor Manufacturing Company Limited, which at the time of writing is the second most valuable semiconductor company in the world. What's more, Asia's consumer class is now larger than the rest of the world combined and is set to grow further.

Overlaying all of this, from a fundamental perspective, is that equity valuations are now very compelling vs developed markets. As at the end of 2023, global developed markets traded at a forward price-to-earnings ratio (P/E)* of more than 17x, whereas the Asia Pacific ex Japan region was close to 13x.

In order to benefit from this, we feel that a high-quality approach, with diversification and downside protection embedded in the process, is a great way to play the region.

Schroder Asian Total Return is one such strategy, managed by veterans Robin Parbrook and King Fuei Lee. The trust seeks to identify companies that can produce a high and sustainable return on capital within the Asia Pacific ex Japan region. The 'Pacific' region includes exposure to Australia, which is a prominent region in the benchmark and this trust.

The portfolio invests in 40-70 companies through the cycle, with historic overweight exposure to technology and healthcare. It also focuses on quality and 'total return' results in an approach which has meaningfully protected capital relative to its peers, and which manages to reduce volatility in naturally riskier markets.

The trust currently trades at a 5.4% discount, which is double the 12-month average rate, and in our view represents a compelling opportunity to invest.

Kamal Warraich
Head of Equity Fund Research

*See glossary for definition.

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Schroder Asian Total Return

Share price	422p
Market cap	£409m
NAV* per share	446p
Discount	5.4%

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Profit takers

In addition to providing insight and analysis of particular investment opportunities each month, we also review stocks that have shown strong performance in recent months and as a result investors might consider taking profits. Please do contact your Investment Manager to discuss any of these ideas, or indeed any aspect of your portfolio held at Canaccord Genuity Wealth Management.

							Performance over previous		
Company name	**Market cap (£m)**	**Share price (p)**	**Prior FY dividend per share (p)**	**Current FY dividend per share (p)**	**Prior FY price earnings ratio**	**Current FY price earnings ratio**	**1 mth**	**3 mths**	**6 mths**
Trustpilot	752	180	0.0	0.0	-33.9	206.7	21%	80%	105%
Rolls-Royce	25,187	301	0.0	0.1	7.9	18.7	1%	40%	63%
Craneware	752	2,150	27.8	28.2	27.6	30.8	23%	36%	57%
Ascential	1,352	305	0.0	0.0	15.3	21.7	4%	16%	46%
Next 15 Group	904	915	14.6	15.5	12.1	10.1	10%	45%	44%
Bridgepoint Group	2,133	269	8.0	8.8	20.5	16.0	-4%	48%	42%
Smart Metering	1,269	951	30.3	32.8	53.9	49.4	1%	49%	36%
Mortgage Advice Bureau	486	850	28.1	28.1	31.8	22.3	4%	50%	36%
Genuit Group	1,052	424	12.3	12.3	17.0	12.7	5%	60%	36%
Ocean Wilsons Holdings	477	1,350	58.1	56.5	20.7	8.7	13%	44%	35%
Quilter plc	1,393	105	4.5	4.7	8.5	11.4	2%	31%	34%
Paragon Banking Group	1,492	704	28.6	34.0	8.0	6.2	1%	59%	33%
Hollywood Bowl	513	299	11.8	12.1	10.4	13.8	-2%	20%	33%
Computacenter	3,284	2,904	67.9	71.2	14.0	13.5	4%	13%	32%
Intercontinental Hotels	12,335	7,500	114.9	127.9	28.7	19.9	6%	29%	30%
Johnson Service	606	146	2.4	2.8	13.6	15.1	3%	14%	30%
Taylor Wimpey	5,231	148	9.4	9.4	6.1	12.4	1%	34%	30%
Elementis	837	142	0.0	1.6	12.3	14.2	12%	20%	29%
DCC	5,690	5,756	187.2	194.4	11.1	12.4	0%	26%	28%
Vistry Group	3,445	1,005	55.0	40.4	5.8	8.9	10%	42%	27%
Bytes Technology Group	1,578	657	7.5	13.9	25.2	32.6	7%	33%	27%
Clarkson	1,091	3,550	93.0	97.6	12.8	11.5	12%	34%	27%
Intermediate Capital	5,116	1,786	77.5	80.3	16.9	13.3	6%	37%	27%
BAE Systems	35,567	1,177	27.0	30.0	11.3	15.7	6%	7%	26%
Persimmon	4,672	1,463	60.0	60.3	10.5	14.6	5%	44%	26%
Sage	11,932	1,178	19.3	20.6	25.7	32.7	1%	21%	26%
3i Group plc	23,907	2,479	53.0	59.2	2.8	5.9	2%	28%	25%
Trainline	1,526	330	0.0	0.0	81.5	52.0	3%	27%	25%
Bellway	3,288	2,760	140.0	54.1	6.3	22.5	8%	32%	25%
RELX PLC	61,269	3,262	54.6	58.3	22.4	23.6	5%	14%	25%

Source: Quest®

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Past performance and future forecast figures are not a reliable indicator of future results.

Glossary

The glossary is not intended as a technical definition as most of these metrics can be calculated in a number of different ways.

Common Equity Tier 1 (CET1)	Covers liquid bank holdings, such as cash and stock, held by a bank or financial institution. CET1 was a measure introduced in 2014 to protect from financial crisis.
Compound annual growth rate (CAGR)	Compound annual growth rate (CAGR) is the rate of return that would be required for an investment to grow from its beginning balance to its ending balance, assuming the profits were reinvested at the end of each year of the investment's lifespan.
Dividend per share (DPS)	Dividend per share (DPS) is the sum of declared dividends issued by a company for every ordinary share outstanding. The figure is calculated by dividing the total dividends paid out by a business, including interim dividends, over a period of time by the number of outstanding ordinary shares issued.
Dividend yield	Dividend per share divided by the share price, often expressed as a percentage. For historic periods the average share price for the year is used, for forecasts the current share price is used.
Earnings per share (EPS)	An indicator of a company's profitability, it is the portion of profit after tax allocated to each outstanding share in issue.
EBITDA	Earnings before interest, taxes, depreciation, and amortisation (EBITDA) gives an indication of a company's financial performance.
Economic moat	Refers to a business's ability to maintain competitive advantages in order to protect its long-term profits and market share from competing firms.
Enterprise value	Enterprise value is defined as equity market capitalisation plus net debt. This metric may be used to value a company for a potential takeover.
Financial year end	Financial year end refers to the completion of a 12-month accounting period that may differ from the calendar year. If a company's financial year ends 31 March, H1 refers to the period between April and September, and H2 refers to the period between October and March.
Gross margin	Gross margin is net sales less the cost of goods sold. It's the amount of money a company retains after incurring the direct costs associated with producing the goods it sells and the services it provides.
Growth stocks	A company that is expected to deliver better than average organic revenue and earnings growth over the medium term.
Net asset value (NAV)	The net asset value (NAV) represents the net value of an entity and is calculated as the total value of the entity's assets minus the total value of its liabilities. Most commonly used in the context of a mutual fund or an exchange-traded fund (ETF), the NAV represents the per share/unit price of the fund on a specific date or time.
Next twelve months (NTM)	Next twelve months (NTM) refers to any financial measure that is forecast for the immediate next twelve months from the current date.
Price earnings ratio (P/E)	Share price divided by EPS. For historic periods the average share price for the year is used; for forecast years, the current share price is used. It shows how much investors are willing to pay per pound of earnings.
Price to tangible book value (PTBV)	The valuation ratio that compares the price of a security to a company's physical assets, according to their balance sheets. PTBV is considered an accurate estimate of the company's net value to shareholders as it excludes intangible assets such as trademarks and intellectual property.
Quest®	Canaccord Genuity's proprietary online valuation and analytical tool which combines consensus market figures with the Quest® Discounted Cash Flow (DCF) Valuation Model.
Return on Tangible Equity (RoTE)	Calculated by dividing the net earnings applicable to shareholders by the average monthly tangible common shareholders' equity. It is the total shareholder's equity once preferred stock, goodwill and any other intangible assets have been identified and removed.
Short selling	Selling of a stock that the investor does not own. Considered a high-risk strategy that involves speculating on the decline of a stock or security's price, by borrowing shares and then selling them to buyers willing to pay the market price.
Tables	F – forecast results, figures based on the combined estimates of analysts covering the company. A – actual results, figures based on the company's published results.
Value stocks	Investors looking for 'value' seek out stocks which they believe have been undervalued by the market and are trading for less than their intrinsic worth. They are viewed as trading at a lower price than justified when measured against metrics such as earnings, profit margins or sales.

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Investment Recommendation:

Date and time of first dissemination: 05.02.24 - 10AM GMT
Date and time of production: 05.02.24 - 10AM GMT

Buy:

Unless otherwise stated, at the time of the recommendation we consider there is a material upside to the current share price.

Price:

Prices are as at market close on 31.01.24

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