Canaccord Genuity Wealth Management

INTELLIGENT INVESTING
August 2023

Market review

Recent news on inflation has been encouraging. The headline consumer price index rate in June fell from 4.1% to 3% in the US, from 6.1% to 5.5% in the eurozone and from 8.7% to 7.9% in the UK.

This progress towards longer-term central bank targets of 2% is important. Firstly, it allows investors to look forward to a peak in interest rates, which have risen sharply over the last 18 months. Secondly, it indicates possible falls in rates towards the end of 2023 and into 2024.

Markets move based on what investors think will happen. So the hoped-for peak in rates and subsequent falls allow markets to anticipate stronger economic growth, bigger profits and higher valuations.

No surprise, then, that equities have risen following the good news. Crucially, more companies have seen share prices rise compared with earlier in the year, when market leadership was excessively focused on the 'magnificent seven' stocks: Apple Inc.; Microsoft Corporation; Alphabet Inc.; Amazon.com, Inc.; NVIDIA Corporation; Meta Platforms, Inc.; and Tesla, Inc.

Year-to-date, the 'worst performing' of these is Alphabet Inc. (the owner of Google), which is up a paltry 38%. The best, NVIDIA Corporation (a specialised semiconductor maker), is up 205%. The average performance of the seven has been +92% since the end of 2022. Earlier this year, if you excluded these companies, the rest of the market had gone sideways at best and down at worst.

Despite the better news surrounding inflation recently, we still advise caution. The inflation genie is slowly getting put back into the bottle, but this process could take some time. So-called 'sticky' inflation, which impacts the cost of services, rents and healthcare, remains more resistant to falls, and some of the easy gains in goods and energy inflation have already been made. From here, it will be a harder slog.

Moreover, after increases to around 5% in the US and the UK, and a little less in Europe, we have yet to see the full impact higher interest rates will have on economies, companies and consumers.

As such, the anticipated good news in both equities and bonds we've seen recently may encounter some turbulence in the coming months, as the impact of tighter money bites companies and, in the UK in particular, consumers with mortgages.

That said, valuations outside of America and the 'magnificent seven' remain attractive, with the UK in particular on lower valuations compared with the US for the first time in decades. As a result, we'd encourage people to use notable pull-backs to top up positions, especially in companies with decent business models that have fallen significantly.

For the first time in many years, we are seeing investors paid properly for the risks they take, and this makes turbulence more interesting when it comes.

Richard Champion
Deputy Chief Investment Officer, UK

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UK LARGE CAPS

A stroke of Genus

Genus plc (Genus) is a world-leading animal genetics company which develops technologies that enable farmers to produce more animal protein in a more sustainable manner.

By analysing DNA and looking for markers that are linked to desirable characteristics, such as feed efficiency, disease resistance and growth rate, Genus selects and breeds animals with the strongest genetic profile to produce even better offspring. These genetically superior specimens are then distributed to customers in the form of breeding animals, semen or embryos.

Genus is made up of two businesses:

PIC USA, Inc. (PIC) – 75% of profits: the global leading provider of swine genetics with 15% market share, expected to rise to around 35% over time. PIC is increasingly shifting to an attractive royalty model, whereby Genus earns a fee in perpetuity while its genetics are in the herd. The business is also well positioned in China (which makes up 50% of the global pork market) through its joint venture with a state-owned company.

ABS Global, Inc. (ABS) – 25% of profits: the second largest global provider of bovine genetics, enhancing the genetic potential of dairy and beef. In recent years, ABS has moved up the value chain by becoming a breeding company rather than having to rely on third parties to source livestock. This has allowed it to develop a range of innovative solutions, from embryos – the quickest way to improve herd quality – to female-only sperm straws, which sell for three times the price of normal straws as they almost guarantee female offspring.

Although currently pre-revenue, Genus' gene-editing technology is likely to be a major source of growth. In late 2023, the company expects US approval for the first genetically modified pig resistant to PRRSV, a highly infectious and deadly disease which costs US farmers over US$1bn annually. Chinese approval is expected in late 2024, with subsequent filings expected in Brazil, Colombia, Canada and Japan.

Genus plc

Share price	2,418p
Market cap	£1.6bn

	2022A	2023F	2024F
Revenue (£m)	593	689	734
Earnings per share (p)	83.2	74.1	89.3
Dividend per share (p)	32.0	32.2	35.6
Dividend yield	0.8%	1.2%	1.5%
Free cash flow yield	-0.3%	1.7%	2.6%
Price earnings ratio	51.2	37.0	27.1
Return on capital employed	8.3%	8.8%	9.6%
Financial year end*			31 December

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

While accurate revenue projections are impossible, some analysts suggest that Genus could earn US$2 per North American pig; a US$120m revenue opportunity and c.13% of current revenue.

We view the current 27.1x 12-month forward price earnings ratio (P/E)* as very attractive, especially when we account for annual gene editing spend of US$15m. If we were to exclude this $15m, profits would rise c.14% with the P/E falling to 23.8x.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

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UK SMALL CAPS

Transformational growth

Kainos Group plc (Kainos) is a UK-based provider of digital services and platforms, employing over 2,400 people across 17 offices. It has a long history of delivering complex digital transformation projects that save money for customers in both the public and private sectors, and is a leading European partner of Workday, Inc. (Workday), a large US-quoted human capital management software business.

Kainos is responsible for implementing Workday's Software as a Service (SaaS) platform for enterprise customers, is the only specialist Workday partner headquartered in the UK, and is one of only 40 partners globally accredited to implement Workday's platform. In 2018, the company extended its Workday presence by entering the US market, and in 2021 was awarded US Phase 1 Partner status, which has substantially increased its US market opportunity.

The group is split into three divisions:

Digital Services (c.65% of gross profit) – focuses on the delivery of customised online digital solutions, principally for the public sector, to help reduce costs and make services more accessible and easier to use.

Workday Services (c.22% of gross profit) – provides consulting and implementation services to Workday customers. Kainos is experienced in complex deployment and integrations, is the leading pan-European Workday specialist, and is ranked #8 globally.

Workday Products (c.13% of gross profit) – provides software products for customers to assist and add further functionality to the Workday SaaS platform.

Historically, Kainos has achieved a high rate of growth which has been mainly organic. The last results showed significant revenue (+24%) and profit (+15%) growth, following 13 consecutive years of even stronger revenue and earnings growth (with a five-year earnings per share compound annual growth rate of 32%).

Kainos Group

Share price	1,297p
Market cap	£1.6bn

	2023A	2024F	2025F
Revenue (£m)	375	424	480
Earnings per share (p)	33.7	41.1	48.4
Dividend per share (p)	23.9	26.2	28.8
Dividend yield	1.8%	2.0%	2.2%
Free cash flow yield	3.0%	3.6%	3.5%
Price earnings ratio	39.9	31.6	26.8
Return on capital employed	236.4%	316.8%	399.7%
Financial year end*			31 March

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

The shares currently trade on a price earnings ratio (P/E)* of 29.8x over the next twelve months (NTM)*, compared with a three-year NTM average of 38.4x.

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.

GLOBAL EQUITY SCREEN

All-you-can-buy Buffett

A regular pastime for investors is scrutinising regulatory filings of Berkshire Hathaway Inc. (Berkshire) to see where CEO Warren Buffett has been spending. Buffett controls the deployment of Berkshire's excess cash, which stood at a whopping US$129bn at the end of 2022 – 17% of its total market value.

Berkshire operates more than 90 businesses spanning insurance, railroads, ice cream, apparel and gas distribution, amongst others. Even so, people forget that it also has stakes in over 50 publicly listed companies, including huge positions in Apple Inc. (US$157bn), Bank of America Corporation (US$28bn), Coca-Cola Company (US$25bn), American Express Company (US$22bn) and Chevron Corporation (US$20bn).

Berkshire's operating income was US$8.1bn in the first quarter of 2023 alone. It doesn't pay a dividend, and buybacks only occur when the group is trading at below what Buffett terms 'intrinsic value' (typically set at c.20% premium to net assets). It follows that US$129bn of cash is likely to grow rapidly.

It has been three years since Berkshire's last big acquisition, the US$10bn purchase of Dominion Energy, Inc.'s natural gas transmission and storage business. Since cash generates lower returns than the businesses he typically invests in, Buffett is likely coming under increasing pressure to spend some of it, with the easiest avenue to do so being to increase his portfolio of public companies.

Whether this involves a full cash bid, increasing existing positions or adding new ones, any of these options would be positive for shareholders of the target companies.

We've produced a table of companies with similar characteristics to those that Berkshire has bid for in the past, including market value, size of Buffett's current position and whether he has added to it, debt levels, the type of business and whether it has what Buffett terms a 'sustainable economic moat'*.

Despite it being a tiny holding for Berkshire at just c.US$10m, we've taken the liberty of including Diageo plc (Diageo) in this list, given that in May Berkshire announced it had invested in Diageo for the first time in over 25 years.

Buffett has history with Diageo: in 1991 it was the first significant investment Berkshire had made in a non-US domiciled company. Although Diageo is the eighth largest UK-listed company, Buffett could afford to pay a 20% takeover premium compared with the current price, and still have US$15bn beer (or whisky, as the case may be) money left in his (or Berkshire's) back pocket.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

			12-month forward						Price change over		
Stocks	**Industry**	**Market cap (£bn)**	**Price earnings ratio**	**EPS growth**	**Dividend yield**	**Dividend cover**	**Net debt/ EBITDA**	**1mth**	**3mths**	**12mths**
Unilever PLC	Personal care products	105.2	17.8	1.3%	3.7%	1.5	2.1	2%	-6%	5%
Diageo plc	Beverages	76.0	19.9	2.8%	2.5%	2.0	2.7	0%	-7%	-12%
GSK plc	Pharmaceuticals	55.4	9.1	1.9%	4.4%	2.5	0.9	-2%	-6%	-19%
RELX PLC	Professional services	49.3	22.3	8.9%	2.3%	1.9	1.6	0%	4%	8%
Reckitt Benckiser	Household products	41.3	16.5	2.3%	3.4%	1.8	2.2	-3%	-11%	-15%
Sage	Software	9.5	27.3	10.1%	2.2%	1.7	1.5	1%	14%	32%
Bunzl	Trading companies and distributors	9.5	15.8	-1.5%	2.4%	2.6	1.2	-6%	-10%	-8%
IMI	Machinery	4.2	13.5	12.5%	1.9%	3.9	1.4	-2%	1%	27%
RS Group	Trading companies and distributors	3.7	13.3	-2.6%	2.8%	2.7	0.1	3%	-15%	-24%
Britvic	Beverages	2.2	14.2	8.0%	3.7%	1.9	1.8	0%	-7%	2%
4imprint	Media	1.5	20.2	6.5%	2.8%	1.9	-0.6	8%	14%	66%

Source: Quest®

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

US EQUITIES

The patient approach

Johnson & Johnson Services, Inc. (J&J) is a globally recognised healthcare conglomerate that operates across two main divisions: pharmaceuticals and medical technology.

Its medical technology division offers a diverse range of medical devices, equipment, and systems used in hospitals and outpatient surgery centres, including products for general surgery, orthopedics and eye care. This division has experienced significant growth recently, driven partly by the temporary postponement of elective procedures during the COVID-19 pandemic, but also due to an ageing society.

In its pharmaceuticals segment, J&J focuses on drug development in therapeutic areas such as oncology, immunology, infectious diseases and vaccines, neuroscience, cardiovascular and metabolism, and pulmonary hypertension.

J&J boasts a strong pipeline of drugs across all three phases of clinical trials. If these drugs receive regulatory approval, they have the potential to generate peak sales of US$20bn, which would more than offset the loss in sales from drugs facing patent expiration and competition. Furthermore, key clinical trials have shown promising results, further bolstering the outlook.

Additionally, J&J holds a substantial ownership stake of approximately 90% in its recently spun-off consumer healthcare business, Kenvue Inc. (Kenvue). Kenvue comprises well-known brands such as Listerine, Neutrogena and Nicorette. That being said, J&J intends to gradually decrease its stake in Kenvue by distributing shares of the company to its existing shareholders in the future.

Like all healthcare companies, J&J faces key risks, such as drugs losing patent protection (like Stelara and Xarelto) or facing potential competition (like Imbruvica). However, we believe that its robust pharmaceutical pipeline, its diverse technology division and its strong portfolio across the consumer healthcare sector – coupled with the fact that its shares are currently trading on a 12-month forward price earnings ratio (P/E)* of 15.4x – make it an attractive investment opportunity.

Johnson & Johnson

Share price	US$169.9
Market cap	US$442bn

	2022A	2023F	2024F
Revenue (US$bn)	94.9	100.1	103.1
Earnings per share (US$)	10.1	10.8	11.3
Dividend per share (US$)	4.5	4.7	4.9
Dividend yield	2.6%	2.8%	2.9%
Free cash flow yield	4.8%	6.5%	6.9%
Price earnings ratio	17.1	15.8	15.1
Return on capital employed	29.3%	34.1%	32.9%
Financial year end*			31 December

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

Dan Smith CFA
International Equity Analyst

*See glossary for definition.

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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

Small but mighty

Many industry voices are saying that the UK is 'cheap' right now. There are numerous reasons for this including, for example, institutional capital flight, political issues such as Brexit, and short selling*.

But there is just as much evidence that, in our view, makes the UK a compelling place to invest – especially the small- and medium-sized companies which are now trading on historically low multiples and look cheap compared with international peers.

A key indicator is the recent boom in mergers and acquisitions (M&A) activity in the UK, which informs us that many UK-listed companies are trading at low valuations relative to their quality. Combined with the fact that many of our listed companies, both large and small, possess international assets and diverse revenue streams, this implies that investors are unfairly tarring the UK stock market with the UK economy brush.

If investors can access these types of shares – good-quality companies on low valuations – via an investment trust trading at below net asset value (NAV)*, then they can benefit from what is known as a 'double discount'.

The Blackrock Smaller Companies Trust is one such way to capitalise on small-cap weakness, and the discount remains at compelling levels. The trust seeks to invest in high-quality, fast-growing businesses that are cash generative, and the team has an excellent long-term track record in achieving this objective. The trust aims to outperform its benchmark UK smaller companies index over five years, and so a long-term holding period with the appropriate tolerance for volatility is necessary.

Blackrock Smaller Companies Trust

Share price	£12.82
Market cap	£623m
NAV* per share	£14.55
Discount	11.9%

Kamal Warraich
Head of Equity Fund Research

*See glossary for definition.

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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
Aston Martin Lagonda	2,990	376	0.0	0.0	-3.1	-16.7	6%	69%	112%
Rolls-Royce	15,457	184	0.0	0.1	7.9	34.9	22%	22%	69%
Melrose Industries	7,028	520	4.9	4.1	15.5	34.6	3%	27%	64%
Alphawave IP Group	1,115	158	0.0	0.0	-68.5	28.4	10%	56%	63%
THG	1,301	100	0.0	0.0	-5.4	-11.1	23%	-14%	62%
Darktrace plc	2,296	359	0.0	0.0	546.5	56.4	17%	27%	57%
Abcam	5,273	23	0.0	0.0	41.6	47.4	-6%	32%	51%
Burford Capital	2,325	1,062	10.4	10.1	43.9	6.5	11%	3%	47%
Centrica	7,672	139	3.0	3.7	2.3	5.3	12%	24%	42%
Carnival plc	15,581	1,237	0.0	0.0	-2.5	-128.8	-5%	84%	41%
Network International	2,064	387	0.0	0.3	20.0	27.9	1%	1%	38%
Wise plc	7,931	774	0.0	0.0	39.9	36.5	18%	45%	32%
Victoria	764	664	0.0	0.0	31.1	11.3	13%	19%	31%
FirstGroup	986	146	3.8	4.1	10.2	13.1	0%	24%	30%
Mitchells & Butlers	1,341	226	0.0	0.0	12.2	18.7	11%	28%	30%
JD Wetherspoon	824	650	0.0	0.9	-34.8	22.8	-3%	-10%	30%
Deliveroo	2,165	124	0.0	0.0	-10.9	-40.8	8%	14%	29%
Marks & Spencer	4,070	206	0.0	5.3	7.4	12.3	7%	25%	28%
Seplat Energy	770	131	8.3	15.0	10.3	3.6	10%	26%	28%
MITIE	1,325	102	2.9	3.1	7.3	10.8	6%	11%	25%
Dominos Pizza Group	1,673	406	10.0	10.1	16.7	23.3	47%	35%	24%
Alpha Group International	970	2,240	14.4	14.8	27.7	30.7	5%	4%	23%
Games Workshop	3,838	11,660	365.0	383.8	19.2	27.7	7%	18%	23%
Babcock International	1,882	372	0.0	9.1	26.4	10.1	32%	16%	22%
Rentokil Initial	15,503	620	7.6	8.0	22.3	27.1	1%	-2%	22%
Dechra Pharma	4,264	3,744	44.9	46.9	51.1	27.2	2%	1%	22%
Hikma Pharma	4,586	2,075	46.5	46.8	9.0	13.4	10%	13%	21%
Bytes Technology Group	1,212	506	7.5	15.3	25.2	25.6	-4%	22%	21%
Ocado	7,230	885	0.0	0.0	-18.7	-20.0	56%	79%	20%
BAE Systems	30,180	993	27.0	30.4	11.3	16.3	7%	-2%	20%

Source: Quest®

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Glossary

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

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.
Quest®	Canaccord Genuity's proprietary online valuation and analytical tool which combines consensus market figures with the Quest® Discounted Cash Flow (DCF) Valuation Model.
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: 07.08.23 - 10AM BST
Date and time of production: 07.08.23 - 10AM BST

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 02.08.23

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