Canaccord Genuity Wealth Management

INTELLIGENT INVESTING
October 2023

Market review

Throughout 2023, there have been several stocks that have done so well that being invested in them, or not, has made or broken performance. We've spoken about some of these in previous issues of Intelligent Investing, typically highlighting the very high valuations on which they often sit.

The two themes that have driven this performance are Artificial Intelligence (AI) and obesity. AI has flourished thanks to the development of functions like OpenAI's ChatGPT, and the semiconductor infrastructure which allows computers to process vast amounts of data. As for the latter, investors have become excited by novel drug therapies that address one of the wealthy world's key health challenges, as obesity levels balloon (pardon the pun).

With NVIDIA Corporation (NVIDIA) widely considered the poster child of AI, and Eli Lilly and Company (Lilly) and Novo Nordisk A/S (Novo) frontrunning for obesity, it is sometimes easy to ignore growth opportunities elsewhere in the market. After all, NVIDIA is up by 198% year-to-date, Lilly by 89% and Novo by 59%. Over five years, the numbers are eye-wateringly good, with share prices up by 1214%, 443% and 348% respectively.

But investing isn't all about the trend of the day. In this edition of Intelligent Investing, we look for other technology or related companies where we think value may be found. Whether it be Oxford Instruments plc in the UK, or Amadeus IT Group, S.A. in Europe, we seek out opportunities in the wider tech space. After all, we want our clients to be invested in winners.

We also look at companies with strong cash generation, which often accompanies the best technology opportunities. In the UK, managements are increasingly looking to list their shares on US exchanges to take advantage of the higher valuations available there. A recent example is the listing of Cambridge-based ARM Holdings plc on the NASDAQ stock market. In this light, we look at Smurfit Kappa Group plc, a company in the seemingly more mundane cardboard packaging sector, which is best-in-class in its field and has chosen to go down this route.

More widely, markets are trying to establish whether the peak in interest rate rises is in sight, in which case we can breathe a sigh of relief and allocate more confidently to equities. Timing aside, investing in high-quality companies, whether in technology or not, should ultimately create good outcomes for our clients.

While we wait for this to happen, we are also cognisant that the final quarter of the calendar year is often (with some occasionally severe exceptions) an excellent time to invest. We are past the 'sell in May' period and can now look forward, we hope, to a 'Santa rally'. After all, it is less than 100 days to Christmas.

Richard Champion
Deputy Chief Investment Officer, UK

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UK
LARGE CAPS

The complete package

Smurfit Kappa Group plc (Smurfit) is Europe's leading corrugated packaging company with 20% market share, and operations in North and Latin America.

As the clear front-runner in a fragmented market, Smurfit leverages its superior scale by offering a global solution across 22 European countries, 13 countries in the Americas and one in Africa. And while the company's class-leading innovation allows it to generate superior margins, its 100% renewable products enable its customers to reduce their environmental footprint.

The corrugated packaging market typically grows 2-3% annually, driven by e-commerce, growth in more sustainable packaging formats, customisable packaging solutions, switching from plastic to corrugated materials, and shelf-ready packaging which speeds up the shelf-stacking process.

The corrugated packaging industry is also likely to be at the forefront of EU initiatives to help make supply chains greener and lower carbon emissions.

Importantly for Smurfit, the US packaging market is years behind Europe from a green perspective, which leads us nicely onto Smurfit's acquisition of WestRock Company (Westrock), a key US competitor, for US$11bn (consisting of 90% cash and 10% shares). Smurfit's share price fell 10% on the announcement as several investors objected to the 36% takeover premium, which they deemed too high.

However, we believe that the positives far outweigh the negatives:

- Smurfit expects the deal to boost earnings per share (EPS)* by at least 20% by the end of the first full year post-completion
- Smurfit is targeting US$400m of annual pre-tax cash savings by the end of the first year post-completion at a one-off cost of just US$235m – although the CFO admits he expects to beat this target
- 65% of group revenue will now be from the US and Latin America, compared with 25% previously. The US has been a key strategic focus for Smurfit in recent years given that most of its US competitors are paper, not packaging, specialists whose intellectual property and innovation track records significantly lag behind Smurfit

Smurfit Kappa Group plc

Share price £27.2
Market cap £7.1bn

	2022A	2023F	2024F
Revenue (€bn)	12.8	11.6	11.5
Earnings per share (€)	4.5	3.3	3.2
Dividend per share (€)	1.4	1.5	1.6
Dividend yield	3.7%	4.6%	4.9%
Free cash flow yield	5.5%	5.8%	8.6%
Price earnings ratio	8.3	9.6	10.1
Return on capital employed	20.8%	15.9%	14.8%
Financial year end*			31 December

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

- Its primary listing will move to New York, which should enable a higher valuation multiple, given higher US equity ratings in general, and that prior to the deal WestRock traded at more than a 30% premium to Smurfit (despite having lower margins and returns)
- Competition issues are expected to be minimal, except in Mexico, which should be easily resolved.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

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UK
SMALL CAPS

Down to a science

Oxford Instruments plc (Oxford Instruments) is the principal provider of high-tech scientific tools to the world's leading industrial and research communities. With sites across the UK, US, Europe and Asia, it is a globally recognised brand with a reputation for world-class product performance.

The business is positioned to address a broad range of markets and industrial sectors, with its key technologies underpinning the shift to a greener economy, increased digital connectivity, and advances in materials, life science and healthcare.

Full-year results announced in June 2023 showed profits up 24% and earnings up 20%, with a record year-end order book of £320m (up 23%), giving good visibility into FY24. There was strong order growth across each of its end markets, supported by the following long-term structural growth drivers: advanced materials, quantum technology, semiconductors, healthcare and life science markets. The three-year compound annual growth rate (CAGR)* of orders was 15%, both to commercial and academic customers.

Over the last five years, earnings have grown at 15% CAGR despite pandemic-related supply chain issues, which are now easing. The group's return on capital employed has steadily increased every year since 2017, starting at 10% and reaching 35% in the FY23 results.

The business has a strong balance sheet (with net cash at £100m) which opens the prospect of future accretive mergers and acquisitions or additional returns to shareholders. There is also takeover potential: Spectris plc put together a bid valuing the shares at £31, but terminated discussions in March 2022 citing the war in Ukraine and weak market conditions. It nevertheless commented that "Oxford Instruments is a quality company and the strategic and financial rationale for a combination of our businesses is highly compelling".

Oxford Instruments plc

Share price £21.85
Market cap £1.3bn

	2023A	2024F	2025F
Revenue (£m)	445	462	480
Earnings per share (p)	103.4	111.2	115.1
Dividend per share (p)	19.5	20.8	21.9
Dividend yield	0.9%	1.0%	1.0%
Free cash flow yield	2.5%	4.5%	4.9%
Price earnings ratio	21.0	19.6	19.0
Return on capital employed	24.7%	27.6%	26.3%
Financial year end*			31 March

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

The shares currently trade on a forward next twelve months' price-earnings ratio (P/E)* of 19.1x, compared with a three-year average of 23.8x.

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

Cash is king

In times of extreme economic uncertainty, such as we are currently facing, it is often sensible to take a step back and adopt a back-to-basics approach to choosing stocks.

One of our favourite adages comes from Alfred Rappaport's 1998 book, Creating Shareholder Value, where he famously proclaimed, "cash is a fact, profit is an opinion". We agree with Rappaport's assertion that cash is harder to massage than declared earnings, given that these earnings rely on accounting conventions and assumptions which are more prone to adjustment than cash flows.

Fast forward 25 years, and despite continuous improvements to accounting standards both in the UK and overseas, we believe that Rappaport's words ring just as true today as they did when he first wrote them. As a result, it has become increasingly risky to rely on accounting earnings as the primary barometer to measure a company's inherent valuation appeal, particularly in times of economic stress.

We believe it is far better to rely on cash flows, which are more difficult to manipulate given that they are tangible and not subjective. This contrasts with accounting earnings, which have gradually become more representative of a company's tax implications than its true underlying net worth.

Quest®, Canaccord Genuity's proprietary equity valuation system which covers more than 18,000 stocks, has a vast database of cash flow metrics that allow us to drill down into a company's operational and, more importantly, cash flow performance. This helps us to determine whether a company which appears to be delivering consistently profitable growth in fact has no clear path to consistent cash generation – and as a consequence is unlikely to deliver sustainable shareholder value.

Please see below a list of 12 companies that have a five-year consistent record of converting most of their profits into cash and appear attractively valued based on their 12-month forward data.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

			Cash conversion			12-month forward			Price change over		
Stocks	**Industry**	**Market cap (£m)**	**5yr avg**	**3yr avg**	**Risk percentile 1 = Highest risk 100 = Lowest risk**	**P/E**	**EV/EBITDA**	**Dividend yield**	**1mth**	**3mths**	**12mths**
Schroders	Capital markets	7,533	139%	110%	92	11.7	3.2	5.4%	1%	-6%	-2%
Vistry Group	Household durables	3,203	120%	84%	77	9.8	6.9	5.0%	28%	45%	42%
IG Group Holdings	Capital markets	2,624	117%	86%	90	6.5	3.4	7.1%	-1%	-2%	-13%
Man Group	Capital markets	2,550	131%	87%	95	8.9	6.0	6.4%	7%	1%	-8%
Telecom Plus	Multi-utilities	1,170	137%	103%	95	13.3	7.4	5.9%	-7%	-2%	-15%
Plus500	Financial services	1,111	109%	105%	98	6.2	1.1	4.2%	-3%	-7%	-17%
Morgan Sindall	Construction and engineering	982	133%	100%	90	9.0	3.4	5.1%	10%	23%	38%
Impax Asset Management	Capital markets	598	158%	103%	99	11.7	6.3	6.2%	-11%	-17%	-13%
FDM Group Holdings PLC	IT services	556	123%	90%	97	14.0	8.4	7.3%	-12%	-13%	-24%
Foresight Group Holdings	Capital markets	537	171%	101%	83	11.6	7.4	5.2%	-4%	3%	14%
Jupiter Fund Mgmt	Capital markets	501	127%	100%	88	7.8	1.9	6.7%	1%	-9%	2%
Crest Nicholson	Household durables	474	133%	111%	76	13.7	6.9	6.2%	9%	-4%	-5%

Source: Quest®

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

EUROPEAN EQUITIES

Direction of travel

Amadeus IT Group, S.A. (Amadeus) is a global leader in travel technology, with its platforms connecting service providers – including airlines, hotels and rail companies – with sellers, such as online travel agents. Most of Amadeus' revenues are generated from the airline industry.

Amadeus operates across three primary business divisions, its largest being Air Distribution. In this segment, the company's flagship offering is its Global Distribution System (GDS). This platform serves as a link connecting travel agents to multiple airlines, enabling them to access and book flights using real-time data. The key advantage of this offering is that Amadeus generates a fee per booking that is not linked to flight prices, which shields it from the competitive pricing environment within the airline industry and helps contribute to a more stable revenue profile.

The company's second-largest business division is Air IT Solutions, which provides technology solutions for airlines and airports. The technology includes Passenger Service Systems (PSS), which help to manage seat capacity, check-ins and other boarding functions, with Amadeus generating a fee per passenger boarded. Meanwhile, its airport solutions include technologies that help improve the operational management of airports, including baggage management and flight departures. Most of this division's revenue is generated from software subscriptions.

Amadeus' third business division, Hospitality & Other Solutions, primarily sells reservation and property management software to hotels, with revenues generated from a mixture of transaction- and subscription-based revenues.

One of the key attractions of Amadeus has been the strong growth in global travel volumes. From 1970 up to the COVID-19 pandemic, the rate of passenger growth in air traffic had consistently outpaced global real GDP growth by 1.6x. This trend aligns with the broader shift in consumer behaviour, prioritising experiences over products.

While global travel volumes have rebounded strongly, they remain below pre-pandemic levels. Only North America has surpassed pre-crisis figures, with Asia Pacific, Central, Eastern and Southern Europe and Latin America still 20% below pre-2020 levels, according to Amadeus' most recent financial data.

We expect air travel to continue to recover. We also think the longer-term trends will reassert themselves. Amadeus should therefore remain resilient, given its largely transaction-based business model.

Amadeus IT Group, S.A.

Share price	€59.80
Market cap	€26.9bn

	2022A	2023F	2024F
Revenue (€bn)	4.5	5.5	6.2
Earnings per share (€)	1.5	2.4	2.9
Dividend per share (€)	0.7	1.0	1.3
Dividend yield	1.3%	1.7%	2.2%
Free cash flow yield	2.6%	4.2%	4.8%
Price earnings ratio	37.7	25.0	20.5
Return on capital employed	13.1%	21.6%	24.3%
Financial year end*			31 December

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

Dan Smith CFA
International Equity Analyst

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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

Mortgage interest

The origins of Scottish Mortgage Investment Trust date back to the 'Panic of 1907', a financial crisis in which the New York Stock Exchange fell almost 50% from its peak the previous year.

By 1909, the growing popularity of motor car technology was creating significant demand for tyres, but due to the crisis, credit was in short supply. The 'Straits Mortgage and Trust Company Limited', as it was originally called, was established to take advantage of this situation, and facilitate credit to rubber planters. Within a few years the crisis was over and rubber planters no longer required capital from Straits Mortgage Company. By 1913, the Trust's remit widened to include global equity markets, and its name changed to Scottish Mortgage and Trust Company.

The history is relevant, if only to demonstrate that the Trust has shown resilience and adaptation through countless periods of turmoil over the past century, including world wars, pandemics and financial crises.

Today, this investment trust, which is the largest listed in the UK, trades at a discount last seen in the depths of the 2008 recession. Investors might be forgiven for thinking that such a valuation implies the portfolio contains companies where revenues are slowing and profits are suffering. But on the contrary, a cursory glance reveals many well-known stalwarts including Amazon.com, Inc., NVIDIA Corporation, Netflix, Inc. and Ferrari S.p.A. Through another lens, the Trust concentrates its exposure within long-term mega-trends such as digitalisation, healthcare innovation and decarbonisation.

Scottish Mortgage Investment Trust

Share price	657p
Market cap	£9.2bn
NAV* per share	807p
Discount	18.6%

The recent governance-related concerns unveiled by a former board member had nothing to do with the fund management team and their investment process. We have examined the policies in place regarding gearing, liquidity and private equity exposure, and have come away with confidence.

We believe that for investors with a suitably long-term time horizon and tolerance for volatility, there is the potential to generate significant returns from here.

Kamal Warraich
Head of Equity Fund Research

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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
Burford Capital	2,540	1,161	10.4	10.6	43.9	9.7	9%	21%	104%
888 Holdings	494	110	0.0	0.0	294.7	9.5	-11%	5%	100%
Abcam	5,207	23	0.0	0.0	41.6	51.4	-3%	1%	75%
Lookers	502	129	3.0	3.6	4.3	9.2	1%	9%	62%
Centrica	9,034	166	3.0	4.0	2.3	5.5	13%	40%	61%
Network International	2,079	390	0.0	0.8	20.0	26.1	1%	2%	60%
Darktrace plc	2,713	414	0.0	0.0	43.9	45.4	20%	28%	58%
Carnival plc	12,892	1,024	0.0	0.0	-2.5	-90.6	-9%	5%	57%
Ocado	5,569	682	0.0	0.0	-18.7	-14.8	-8%	29%	55%
Marks & Spencer	4,652	236	0.0	5.5	7.4	12.9	9%	25%	55%
Numis	363	337	13.5	13.5	28.8	-	1%	1%	54%
Rolls-Royce	18,372	220	0.0	0.0	7.9	23.6	8%	42%	53%
Volex	566	312	3.9	4.0	14.1	11.9	-1%	12%	51%
FirstGroup	1,019	152	3.8	4.1	10.2	13.5	5%	8%	50%
Dechra Pharma	4,332	3,804	44.9	46.9	51.1	27.6	0%	5%	49%
Petrofac	387	75	0.0	0.0	-2.3	-2.4	2%	3%	48%
Moonpig Group	558	163	0.0	0.0	15.1	15.7	0%	23%	46%
Bank of Georgia	1,531	3,640	234.3	284.7	2.4	4.1	5%	20%	44%
Melrose Industries	6,410	474	4.9	4.1	15.5	28.4	-7%	-3%	43%
TBC Bank Group	1,602	2,965	166.9	184.8	2.8	4.9	6%	19%	37%
Dominos Pizza Group	1,540	379	10.0	10.2	16.7	21.0	-2%	37%	37%
Bytes Technology Group	1,221	510	7.5	15.3	25.2	25.6	6%	0%	37%
Mitchells & Butlers	1,294	218	0.0	0.0	12.2	17.5	0%	7%	36%
Ergomed	685	1,344	0.0	0.0	31.3	30.8	32%	41%	34%
Sage	10,232	1,001	18.4	19.3	24.0	32.3	5%	15%	33%
3i Group plc	19,735	2,050	53.0	59.0	2.8	6.0	7%	11%	33%
AO World	485	84	0.0	0.0	32.5	30.4	1%	-2%	33%
MITIE	1,332	103	2.9	3.2	7.3	10.2	10%	6%	29%
RHI Magnesita	1,334	2,832	141.9	148.7	7.3	7.1	3%	6%	28%
Indivior	2,450	1,776	0.0	0.0	14.8	15.9	1%	-1%	28%

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: 02.10.23 - 10AM BST
Date and time of production: 02.10.23 - 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 27.09.23

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