Canaccord Genuity Wealth Management

INTELLIGENT INVESTING

December 2023

Market review

In recent years, financial markets have danced to the rhythm of monetary policy. But since the beginning of last year this has been a difficult beat to follow, as central banks conduct the most aggressive global interest rate hiking cycle in history, in an attempt to bring inflation back to heel. It seems now, with inflation softening and global economies cooling, we are likely coming to the end of these orchestrations.

In recent weeks, the narrative around central banks has somewhat shifted. The debate has moved away from "have central banks finished hiking?" towards "when will central banks start cutting?". This dynamic shift has brought about a stark change in market momentum. Since the Federal Reserve's policy meeting at the start of November, markets have gone to the races. Month-to-date, the US equity market has rallied 10.9% (in US dollar terms), while the mid-cap UK FTSE 250 Index has, for a change, led global markets higher, posting 9.6% month-to-date, at the time of writing. The monetary policy climate could prove more supportive for investors going forward.

Economic activity remains unbalanced and ambiguous. The US economy has been a consistent outperformer, though there is growing evidence that the world's largest economy is starting to slow. Europe and the UK have so far skirted a recession, although economic activity has been unimpressive. This could well be a better outcome than many expected, but 2024 is likely to bring further challenges.

The deteriorating macro backdrop has been largely reflected in equity valuations. Since the lofty heights of 2021, equity market valuations have come down significantly and seem much more attractive. For example, the UK market is trading at a 12-month forward price-to-earnings (P/E)* multiple of 10.7x – down more than 40% from the highs of 2021, and now at a 14% discount on this P/E basis vs. the long-run median average. Similarly, the US market has become a lot cheaper, although it does seem more expensive on an index level when compared against historical trends.

The index data doesn't tell the full story, however – particularly for the US. The other defining feature of this market has been its narrowness. Three quarters of the 22% year-to-date return of the index has been driven by the 'magnificent seven' stocks (Amazon.com, Inc., Apple Inc., Alphabet Inc., Meta Platforms, Inc., Microsoft Corporation, NVIDIA Corporation, and Tesla, Inc.). The remaining 493 constituent companies had, before November, contributed negatively to the index return. If you had not been invested in these seven stocks, this year will have been a much more difficult story than the optics of the index suggest.

Amongst these dynamics, it is possible to find opportunities thrown up by the dispersion, including corporates with attractive fundamentals and resilient companies on compelling valuations – some examples of which provide the meat for this issue of Intelligent Investing.

Thomas Hibbert
Investment Analyst

*See glossary for definition.

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UK LARGE CAPS

Equipped for growth

Ashtead Group plc (Ashtead) is one of the world's largest product rental companies, with 97% of earnings coming from its US and Canadian businesses. Customers range from private individuals to multinationals across several industries including construction, manufacturing, facilities management and leisure. Although the majority of Ashtead's fleet comes under its 'general tool' business, its main operating subsidiary, Sunbelt Rentals (Sunbelt), continues to take share.

The US is expected to deliver robust growth as it benefits from a variety of structural growth drivers:

- **Growing rental market:** The US rental market is less mature than Europe, but the gap is closing as they shift from an ownership to a rental mindset due to rising labour costs and increasingly complex equipment
- **Product specialities:** Ashtead's 'speciality' business lines, which include power, climate control and floor cleaning, present a new, higher-growth focus in markets that are less penetrated and price-sensitive than traditional tool hire
- **Construction activity:** The recent Infrastructure, CHIPS and Science, and Inflation Reduction Acts amount to c.US$2trn of direct or indirect funding, helping to drive construction activity.

Ashtead holds top-two market positions in highly fragmented markets in which larger players are increasingly using technology as a key differentiator against smaller peers. This has helped it deliver best-in-class margins and returns, which improve as its estate matures. Meanwhile, Sunbelt's US market share has increased from 4% in 2010 to 13% at the time of writing (the long-term target is over 20%).

Although tool rental is a cyclical industry, Ashtead has a proven track record of managing the cycle and has taken several steps in recent years to mitigate potential volatility.

Despite record first-half profits, the share price fell 10% when Ashtead announced that full-year profits would be 2-3% below consensus analyst forecasts, due to lower levels of emergency response activity (hurricanes, wildfires etc.), coupled with the writers' and actors' strike, which impacted its Canadian film and TV business. Both headwinds have continued into Q3.

Ashtead Group plc

Share price	£47.34
Market cap	£20.7bn

	2023A	2024F	2025F
Revenue (£m)	7,690	8,740	9,712
Earnings per share (p)	307.2	330.8	379.8
Dividend per share (p)	79.5	82.4	93.7
Dividend yield	1.7%	1.7%	2.0%
Free cash flow yield	11.2%	0.8%	3.9%
Price earnings ratio	14.9	14.3	12.5
Return on capital employed	16.7%	18.5%	19.7%
Financial year end*			30 April

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

Notwithstanding these setbacks, the underlying investment case remains fully intact. Given its strong balance sheet, proven success from both acquisition and organic growth, and a highly cash-generative business model, we believe Ashtead's recent share price weakness presents a very attractive entry point, with the shares down 27% from their all-time high in November 2021.

Simon McGarry
Head of Direct Equity Research

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UK SMALL CAPS

Acquisitive nature

Founded in 1985, Ashtead Technology Holdings plc (Ashtead Technology) was originally part of Ashtead Group – featured above as our chosen large-cap stock – before being sold in 2008.

While the Group operates more broadly across the equipment rental space, Ashtead Technology was established to provide customers in the North Sea and beyond with high-specification survey and remotely operated vehicle (ROV) equipment. In November 2021, it was introduced to the Alternative Investment Market (AIM) and has since made several complementary acquisitions.

Through organic growth and strategic corporate purchases, Ashtead Technology has fast-evolved into a world-leading subsea equipment rental and solutions business, serving the global offshore energy sector. With over 300 employees, it serves its customers through ten international technology and service hubs.

The breadth, depth and reliability of the Ashtead Technology fleet – the largest independent fleet in the market – continues to provide a competitive advantage. A large proportion of Ashtead Technology's revenue comes from the rental of equipment to customers (FY22: 71%). However, the company enhances its offering through its product selection, availability, and application of technological know-how – as well as from servicing and assembling equipment. This expertise adds value for customers, helping drive customer loyalty and improve margins.

There are acquisition options open to the firm in a highly fragmented market. It most recently announced a highly accretive £54m acquisition of ACE Winches, which brings complementary lifting, pulling and deployment solutions into Ashtead Technology's expanding mechanical solutions business, whilst helping facilitate further international expansion.

High energy prices have left the energy industry well-capitalised which, combined with a need for alternative energy supplies, has led to high demand for Ashtead Technology's services. Although the industry is cyclical, demand is predicted to remain positive which, alongside the company's broadened capabilities through acquisitions, should lead to continued earnings growth. The shares currently trade on a forward next 12 months' (NTM)* price-earnings ratio (P/E)* of 16x, compared with a two-year average of c.24x.

Ashtead Technology

Share price	£4.85
Market cap	£386m

	2022A	2023F	2024F
Revenue (£m)	73.1	101.6	112.1
Earnings per share (p)	15.2	28.3	30.6
Dividend per share (p)	1.0	1.1	1.3
Dividend yield	0.4%	0.2%	0.3%
Free cash flow yield	9.5%	3.7%	4.4%
Price earnings ratio	15.9	17.2	15.8
Return on capital employed	16.6%	27.4%	27.7%
Financial year end*			31 December

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

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

Quest for quality

Although the recent optimism linked to anticipated accommodative monetary policy (see our market review) has spurred a risk-on rally, at Canaccord Genuity Wealth Management we remain steadfast in our view that investing in quality stocks will generate outperformance compared with other investment styles in the long run.

The qualifier of 'quality' stocks refers to businesses with a lower risk of bankruptcy and above-average growth rates, which often offer investors a relatively safe haven in the event of global economic challenges. We define quality companies as those that have a healthy blend of the following characteristics:

- A stable business model protected by a wide moat
- Strong cash flows that are predictable and steadily growing, and thus drive progressive earnings and dividend growth
- High and defensible returns on invested capital
- Management that is correctly aligned with shareholder interests
- A healthy balance sheet without excessive debt
- Rational capital allocation and a commitment to generate excess returns over the cost of capital, either to reinvest in the business, consolidate in their business areas or, if this is impossible, to return to shareholders
- Low regulatory or external business model risk.

One such example of a quality company is Diageo plc (Diageo), which announced a profit warning three weeks ago as a result of de-stocking in its Latin American and Caribbean business, which equates to c.11% of group sales. Having spent more time than we'd like to admit sifting through both internal and external research, as well as company presentations, we are firmly of the view that our investment case remains intact, and that Diageo still satisfies all of our quality criteria.

Indeed, it's worth highlighting that the reason we have liked Diageo for several years is because of its market-leading premium brands, which provide higher organic growth and better margins than most other consumer goods categories. As a result, we don't expect it to take long for Diageo to once again be viewed by the wider market as a high-quality stock.

To find other opportunities to invest in quality stocks, we have used Quest®*, our proprietary equity valuation tool with over 18,000 stocks under coverage. This generates a list of names we believe are the most attractive quality stocks in the UK market, which can be seen below.

Simon McGarry
Head of Direct Equity Research

*See glossary for definition.

			12-month forward							Price change over	
Stocks	Industry	Market cap (£m)	Price earnings ratio	Dividend yield	Dividend cover	EBIT margin	Net debt/ EBITDA	years of consecutive dividend growth	Risk score 1 = Highest risk 100 = Lowest risk	1mth	12mths
RELX PLC	Professional services	57,319	24.8	2.1%	1.9	31.8%	1.5	12	89	8%	33%
Ashtead Group plc	Trading companies and distributors	20,679	13.3	1.9%	4.0	28.1%	1.5	18	60	1%	-5%
Sage	Software	11,539	31.0	1.8%	1.8	22.9%	0.7	34	71	17%	44%
Halma	Electronic equipment instruments and components	8,011	25.2	1.0%	3.8	20.4%	1.0	28	99	17%	0%
Spirax-Sarco Engineering	Machinery	6,753	26.2	1.8%	2.1	21.6%	1.9	26	87	13%	-18%
Croda Intl	Chemicals	6,165	24.8	2.5%	1.6	18.4%	1.2	24	54	4%	-34%
Diploma	Trading companies and distributors	4,522	24.6	1.8%	2.3	19.6%	1.0	24	91	20%	23%
Intermediate Capital	Capital markets	4,477	11.4	5.5%	1.6	57.0%	0.6	7	52	21%	30%
Hikma Pharma	Pharmaceuticals	3,808	10.5	2.8%	3.4	22.9%	1.3	5	85	-10%	15%
Spectris	Electronic equipment instruments and components	3,439	16.4	2.5%	2.4	17.9%	0.1	27	51	15%	7%
GlobalData	Professional services	1,220	19.7	3.2%	1.6	36.7%	2.7	8	56	3%	-12%
Bodycote	Machinery	1,096	11.2	4.1%	2.2	15.6%	0.2	13	58	1%	-2%
Gamma Communications	Diversified telecommunication services	1,060	13.8	1.7%	4.3	15.2%	-1.2	9	100	7%	-1%
IntegraFin	Capital markets	861	18.5	3.8%	1.4	37.7%	-3.7	5	63	23%	-11%
Judges Scientific	Machinery	605	24.2	1.1%	3.8	20.2%	0.0	17	69	12%	17%

Source: Quest®

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

US EQUITIES

Shifting into Copilot

Microsoft Corporation (Microsoft) is a technology powerhouse, boasting a diversified revenue stream encompassing productivity software such as Office 365 and Dynamics 365, the cloud computing platform Azure, and a multitude of other ventures including LinkedIn, cybersecurity and gaming.

Microsoft is expected to see an uplift in revenues following the recent announcement of price increases for one of its Copilot programs. Microsoft Copilot introduces artificial intelligence (AI) to automate tasks and improve users' productivity. These Copilot programs span all of Microsoft's software suites, including Microsoft 365 – consisting of Word, Excel, PowerPoint and Outlook – as well as other software applications, like the enterprise and sales software Dynamics 365.

Most Copilot programs are still in trial mode, but the company announced in September that its Microsoft 365 Copilot would be available for all enterprise customers from 1 November, at an additional cost of US$30 per user per month. Given that Microsoft 365 has over 300 million users, the revenue opportunity for this program alone is substantial – and Microsoft is expected to implement price hikes for additional Copilot programs in the future.

The wider integration of AI across software applications is likely to boost other parts of Microsoft's business too. AI is compute-intensive and requires large datasets to train AI models. Once AI models are in production, data needs to be stored and analysed – tasks ideally suited to cloud computing data centres.

Through Azure, Microsoft has become a market leader in cloud computing and is likely to be a major beneficiary of the growth in AI. There is early evidence of this in its recent quarterly earnings report, which showed an acceleration in Azure's revenue growth for the first time in five quarters.

Apart from its Copilot programs and the potential in cloud computing, Microsoft boasts various other significant revenue prospects, notably its revamped AI-powered Bing search engine, which could present a challenge to Google's dominance in search queries.

Microsoft is also a leader in the rapidly expanding Endpoint cybersecurity market, with software to protect various devices and entry points within an organisation's IT infrastructure. Furthermore, the recent acquisition of Activision Blizzard is poised to accelerate Microsoft's gaming revenues.

Dan Smith CFA
International Equity Analyst

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Microsoft Corporation

Share price	US$379
Market cap	US$2,816bn

	2023A	2024F	2025F
Revenue (US$bn)	212	243	277
Earnings per share (US$)	9.7	11.2	12.9
Dividend per share (US$)	2.7	2.9	3.2
Dividend yield	1.0%	0.8%	0.8%
Free cash flow yield	2.8%	2.1%	2.5%
Price earnings ratio	27.7	33.8	29.4
Return on capital employed	50.4%	56.9%	61.9%
Financial year end*			31 July

Source: Quest®
Note: 2024 and 2025 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

In utilities we trust

Utilities have long been regarded as 'bond proxies' (assets that behave similarly to bonds) due to their stable cash flows and defensive qualities. Historically, this has been borne out in the data, and there has been a strong negative correlation between the valuation of utility stocks and changes in interest rates. It is for this reason that we've seen a dramatic de-rating (a significant reduction in the valuation of shares) of the sector since central banks began their hiking campaign in 2022.

But there are other important reasons to consider investing in utilities today. The electric power sector is undergoing a profound structural transformation, driven by decarbonisation, and utilities are at the forefront of this global transition.

According to the International Renewable Energy Agency (IRENA), the share of renewable energy in the global energy mix will increase from 16% in 2020 to 77% by 2050, in order to meet the goals set out in the Paris Agreement (the legally binding treaty signed by 196 parties in 2015 to combat climate change). Electricity would provide just over 50% of the total energy mix under these same estimations.

In addition, infrastructure across the world requires major investment to support GDP growth ambitions. These combined factors should act as structural tailwinds for decades, and these themes are now accessible at attractive valuations compared with history.

Ecofin Global Utilities & Infrastructure Trust is one such strategy tapping into these mega-trends. The Trust seeks to achieve a high and secure dividend yield, in conjunction with the potential for long-term growth. The Trust invests in global assets, predominantly across developed markets, with a focus on electric, gas, water and transportation services (roads, ports and railways).

Ecofin targets a 4% yield, which is supported by a healthy balance sheet, and at the time of writing, the discount to net asset value had reached c.18% – the biggest in the Trust's history.

Kamal Warraich
Head of Equity Fund Research

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Ecofin Global Utilities & Infrastructure

Share price	165.5p
Market cap	£191m
NAV* per share	187.9p
Discount	11.9%

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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**
Rolls-Royce	22,027	263	0.0	0.0	7.9	27.5	31%	24%	77%
Hochschild	566	110	1.6	0.3	78.2	87.2	23%	21%	53%
Abcam	5,515	24	0.0	0.0	41.6	50.0	5%	6%	47%
Ocado	4,854	594	0.0	0.0	-18.7	-13.0	23%	-24%	46%
Wise plc	8,006	781	0.0	0.0	39.9	27.4	20%	20%	44%
XPS Pensions Group	488	237	8.4	9.2	16.0	17.2	11%	25%	43%
Tullow Oil	527	36	0.0	0.0	2.8	2.4	8%	-1%	42%
Marks & Spencer	5,002	254	0.0	3.5	7.4	12.5	18%	14%	41%
FirstGroup	1,032	160	3.8	4.8	10.2	13.0	4%	10%	41%
AO World	525	91	0.0	0.0	32.5	31.1	15%	5%	40%
RHI Magnesita	1,333	2,830	141.9	148.0	7.3	7.0	13%	1%	38%
Baltic Classifieds Group	1,084	222	2.2	2.4	35.1	28.9	13%	6%	38%
Kier	483	108	0.0	4.5	5.7	5.3	9%	26%	37%
Deliveroo	2,276	147	0.0	0.0	-10.9	-26.6	23%	28%	36%
Darktrace plc	2,252	354	0.0	0.0	43.9	37.8	3%	0%	36%
THG	1,038	80	0.0	0.0	-5.4	-7.1	27%	-15%	35%
Moonpig Group	621	181	0.0	0.0	15.1	17.5	16%	8%	34%
Frasers Group	3,896	895	0.0	0.0	9.1	10.7	13%	12%	33%
Dominos Pizza Group	1,491	376	10.0	10.3	16.7	20.7	10%	-4%	33%
Greencore	472	99	0.0	2.2	7.6	10.2	14%	19%	31%
Carnival plc	12,999	1,032	0.0	0.0	-2.5	-201.8	23%	-9%	30%
Babcock International	2,006	397	0.0	5.1	26.4	10.6	3%	3%	29%
AB Foods	18,120	2,388	47.3	57.9	11.7	13.7	23%	20%	28%
Hill & Smith	1,495	1,866	35.0	40.6	15.2	18.1	14%	5%	28%
CRH	34,204	4,923	105.4	107.4	10.8	14.0	14%	8%	25%
B&M European Retail	5,776	576	14.6	16.2	11.5	15.2	10%	2%	25%
Cranswick	2,131	3,954	79.4	85.1	15.4	18.0	14%	19%	25%
Centrica	7,925	147	3.0	3.9	2.3	4.8	-5%	-1%	25%
Next	9,601	7,930	206.0	207.6	11.0	14.3	16%	14%	24%

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: 04.12.23 - 10AM GMT
Date and time of production: 04.12.23 - 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 29.11.23

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