CANACCORD Genuity
Wealth Management

Intelligent Investing

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Market Review

Geopolitical uncertainty is at the forefront of many investors' minds right now. The potential for a nuclear conflagration in the Korean peninsula and the uncertainties caused by Donald Trump's all-too-frequent Twitter posts, allied with terrorist outrages in the US and Europe, have conspired to drive a period of modest weakness in equities and other riskier assets. This typical risk-off move in markets has seen equities fall, while government bond yields have gone down and somewhat more risky corporate bonds have struggled to keep pace with the move. Meanwhile, the price of gold has risen, with classic safe haven investments in vogue.

Despite this somewhat weaker tone to markets, economic data across the globe continues to move ahead steadily (with the notable exception of the UK), with inflation failing to break upwards out of its recent range despite very low levels of unemployment in the US, Germany, Japan and the UK. This means central banks have the luxury of allowing the current expansion to continue, without jamming their collective feet onto the brake pedal of rising interest rates – even if reducing the size of their Quantitative Easing-bloated balance sheets remains a priority. In addition, recent corporate earnings announcements have been positive, with a larger proportion of companies beating estimates than for several years prior.

In theory this sounds like an attractive environment for equities, and we continue to like the asset class over bonds. However, we remain aware that valuations are slightly expensive, especially in the US. Having said that, we're seeing a lot of rotation within equity markets, which we view as a good opportunity to buy into strong individual stories at attractive valuations. Although economic conditions are benign, even small disappointments against expectations are being viciously punished, which can create good longer-term entry points into robust companies.

In this light, our UK screen looks to bottom fish among companies that have been hit by recent bad news. Elsewhere, we screen for global growth opportunities. In our focus stocks, we look at the short-term roller coaster that is Merlin Entertainments – owner of attractions such as Thorpe Park and Alton Towers. We also see what's baking at Domino's Pizza – a company where a recently announced slight slowdown in growth prompted a sharp fall in the share price. In the US we polish our views on consumer goods giant Procter & Gamble – a 'quality' stock stalwart. Finally, in our regular piece on investment trusts, we consider Polar Capital Global Financials Trust, which we feel should benefit from a better environment for banks and insurance companies across the world.

We're still waiting for a decent, but as yet elusive, pull back in equity markets before deploying capital to the area more aggressively. In the meantime, we continue to hunt out opportunities thrown up by bouts of market volatility.

Richard Champion

Deputy Chief Investment Officer, UK

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Domino's delivers

Domino's Pizza Group (DPG) is the exclusive master franchisee for Domino's Pizza stores in the UK, Ireland and Switzerland. In 2015 it acquired a minority interest in the master franchisee for Domino's Pizza in Iceland, Norway and Sweden. Founded in Michigan in 1960, the UK's first store opened in 1985. And after 30+ years of stellar growth it's the UK's leading pizza business. The UK & Ireland stores are predominantly operated by franchisees while its overseas territories are mostly operated on a corporate basis.

As market leader, DPG has a variety of scale benefits with respect to the operational/distribution efficiency of the supply chain, stronger buying power and larger advertising budgets. It's also better able to invest in its digital offering which continues to see increased conversion rates and higher order values.

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Under David Wild – CEO since January 2014 – greater emphasis has been placed on improving franchisee profits given that, from 2011 to 2013, their relationships became strained. Average franchisee profits per store have since increased by 61% to £164,000 following a variety of cost-saving measures.

However, DPG has hit a soft patch in 2017, with like-for-like (LFL) growth of just 2.4% in the first six months versus 5.2% in 2016 and a 14-year average of 8.8%. Unsurprisingly, given that DPG's share price is highly correlated with LFL growth, it has fallen by 31% since early March. What's more, some analysts have been eager to pour cold water on management's medium-term target of 1,600 UK stores – versus 1,000 currently – with a view that the UK market is becoming saturated.

We believe these concerns are overdone given that, from a concentration perspective, the UK is still well behind Australia, which continues to generate double-digit LFL growth. And London remains underpenetrated with an aspiration for 125 more stores.

Overseas territories are also showing early signs of improvement with Switzerland breaking even in 2016 for the first time. Also, through its 33% stake in a German joint venture with Sydney-based Domino's Pizza Enterprises, there's material growth potential given that Germany is the world's fourth-largest pizza market. With the shares trading on 17.8x 12-month forward earnings versus a 10-year historical average of 22.4x, this is a tasty opportunity.

Simon McGarry

Senior Equity Analyst

Domino's Pizza Group

Market Cap	£1,319m
Share Price	268p

	2016A	2017F	2018F
Revenue (£m)	361	436	487
Earnings per Share (p)	13.7	14.4	15.6
Dividend per Share (p)	8.0	8.6	9.4
Dividend Yield	2.3%	3.2%	3.5%
Free Cash Flow Yield	2.0%	1.7%	4.7%
Price Earnings Ratio	25.2	18.7	17.2
Return on Capital Employed	57.1%	55.9%	56.9%

Source: Quest®
Note: 2017 and 2018 are forecast years

Star attraction

Merlin Entertainments (Merlin) is a global leader in branded, location-based family entertainment with 64m visitors annually. It's split into three divisions:

- **Midway**: 104 attractions including SEA LIFE, The Eye Brand and Madame Tussauds
- **LEGOLAND Parks**: three parks in Europe, two in the US and two in Asia
- **Resort Theme Parks**: four parks in the UK and one each in Italy and Germany.

Midway (46% of profits) consists of high-quality, chainable brands with global appeal, across a range of markets. Management's focus is to open new attractions in clusters, enabling operating cost, marketing and cross-selling advantages. In 2015 the division acquired a stake in Big Bus Tours, enhancing the strategy of 'owning the visit' in cities where it has attractions. They are targeting 140 Midway attractions by 2020 versus 104 currently, and have identified a further 100+ potential sites.

Merlin's LEGOLAND parks (44% of profits) have developed a mutually synergistic relationship with the LEGO brand with which they have global exclusive rights. These parks are poised to deliver strong growth with Japan and Korea under construction, and negotiations ongoing which could enhance Merlin's US scale and provide access to China's 146m urban middle class.

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Resort Theme Parks performed poorly in the aftermath of 2015's Alton Towers disaster. Having accounted for 17% of 2014 profits, this fell to 10% in 2016. A number of steps have been taken to turn this around. Early signs are encouraging with like-for-like revenue growth of 6.2% in the first half of 2017.

Management is increasing investment in themed family hotels, and intends to open 400 new rooms annually at existing parks from 2016 to 2020 – double the pre-2016 run-rate. Further growth will be driven by adding new rides/features to existing parks. They are also beginning to use tecŠology to better manage customer journeys, as well as create virtual reality rides that handle more customers in less space, and require less capital expenditure than traditional rides.

Considering the global travel and tourism market is expected to grow c.4% annually to 2025, the shares look attractive on 19.3x 12-month forward earnings versus an average of 23x from 2015 to 2016.

Simon McGarry

Senior Equity Analyst

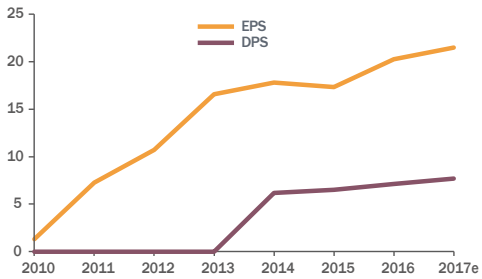
Merlin Entertainments

Market Cap	£4,652m
Share Price	456p

	2016A	2017F	2018F
Revenue (£bn)	1.46	1.61	1.77
Earnings per Share (p)	20.2	21.5	25.2
Dividend per Share (p)	7.1	7.7	8.7
Dividend Yield	1.6%	1.7%	1.9%
Free Cash Flow Yield	2.5%	-0.2%	1.4%
Price Earnings Ratio	22.0	21.3	18.1
Return on Capital Employed	12.8%	12.8%	14.4%

Source: Quest®
Note: 2017 and 2018 are forecast years

Earnings and dividend per share (pence)



Source: Quest®
Note: 2017e relates to a forecast year

Bottom fishing

In general, second quarter results for UK equity markets were positive, with the FTSE 350 and FTSE 250 growing sales by 5.7% and 8.3% year-on-year respectively. In aggregate, there was also a decline in the number of companies issuing profit warnings, with 40% fewer than in the first quarter of 2017 – and almost a third lower than the second quarter of 2016.

Given this robust performance, investors could be forgiven for expecting that, in contrast to last summer which was rocked by the EU referendum, July and August would be reasonably uneventful. In fact, we saw a spike in the number of companies selling off aggressively on the back of negative news. In the last three months, eight companies fell by 15% or more inter-day, compared to just one in the previous three months. Some stocks that fell sharply recently, include:

- **Provident Financial** – fell 66% after a profit warning, FCA investigation and CEO resignation
- **Carillion** – dropped 39% after a profit warning and the resignation of its CEO
- **Indivior** – dropped 35% after a US court patent ruling cleared the way for competitors selling a generic version of its main product
- **Dixons Carphone** – plunged 27% following an unexpected drop in smartphone sales
- **Hochschild Mining** – fell 18% after first-half profits fell by a third
- **AstraZeneca** – down 15% following disappointing lung cancer drug tests
- **AA** – fell 14% after its executive chairman was dismissed for gross misconduct
- **WPP** – dropped 11% after a slowdown in growth.

With this theme in mind, our equity screen considers companies we feel have been sold off indiscriminately, but where the analysts who cover the stock are becoming more positive.

Specifically, our screen searches for stocks trading at more than 20% below their 12-month high, where earnings per share (EPS) are forecast to grow over the next 12 months and where analysts have been revising upwards their estimates for current-year projected earnings. This has produced a list of 11 stocks, shown below:

UK equity screen

Search Criteria

1. Share price is more than 20% below its 12-month high
2. EPS growth is expected to be positive over the next 12 months
3. Consensus analyst forecasts for current year EPS have improved over the last three months.

					12-month forward				
Company name	Industry	Market cap (£m)	Share price as a % of 12-month high	Change in consensus EPS over 3 months	Price earnings ratio	EPS growth	Dividend yield	Dividend cover	Net debt/ EBITDA
Imagination Tech	Semiconductors and Semiconductor Equipment	373	45%	5.8%	27.7	157.2	0.0%	n/a	0.2
IP Group Plc	Capital Markets	787	56%	610.6%	23.8	117.7	0.0%	n/a	-3.6
Kenmare Resources	Metals and Mining	286	71%	0.0%	11.2	110.9	0.0%	n/a	n/a
Cairn Energy	Oil Gas and Consumable Fuels	1,008	71%	28.4%	41.2	193.9	0.0%	n/a	-4.0
Serco	Commercial Services and Supplies	1,182	72%	1.1%	35.9	0.6	0.3%	10.8	1.4
Ladbrokes Coral	Hotels Restaurants and Leisure	2,243	76%	0.0%	8.4	60.6	4.5%	2.6	1.5
Virgin Money	Banks	1,180	76%	2.3%	7.0	9.5	2.4%	6	n/a
Imperial Brands	Tobacco	30,241	77%	0.1%	11.4	7.2	5.7%	1.5	3.0
Indus Gas	Oil Gas and Consumable Fuels	714	77%	0.3%	19.2	25.5	0.0%	n/a	4.9
Dignity	Diversified Consumer Services	1,118	78%	0.6%	17.1	6.7	1.2%	4.8	3.8
Redde	Road and Rail	490	78%	5.0%	14.7	4.3	7.0%	1.0	-0.1

Source: Quest® and Bloomberg

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

Tapping into global recovery

Despite ongoing political unrest in the US, recent nuclear threats from Korea and a tragic backdrop of continued global terrorism, the world economy is actually in pretty good shape at the moment. During the recent second quarter reporting season, companies in the US and Europe have, by and large, beaten expectations. While at the macro level, economic indicators continue to point to a world that remains in synchronised economic recovery. Granted, the pace of growth is not exceptional – but the flip side to this is that the world economy is nowhere near overheating and tipping over into recession.

However, while the outlook is benign from a global perspective, there remain significant regional issues – such as Brexit in the UK or lack of progress on tax reform in the US – that could lead to regional discrepancies to growth over the medium term. Given these localised risks, our preferred method of tapping into global growth is to invest in companies with geographically diverse earnings, where underperformance in one region can be offset by outperformance in another.

Furthermore, we favour companies that are listed on highly regulated exchanges, with adequate levels of corporate governance and in easily tradeable currencies such as the US dollar, sterling or the euro. To that end, we've screened the Canaccord Quest® European and US universe for companies with at least 20% sales exposure to both the Americas and Europe, and at least 20% from outside these regions.

Below, along with some key valuation and growth data, we highlight 16 companies from the screen. These include Procter & Gamble (featured in a separate article in this issue) which is in the midst of a multi-year restructuring programme that should underpin sales and earnings growth for the foreseeable future.

Other companies highlighted include **Alphabet**, the US tech giant and parent of Google; German life sciences multinational **Bayer** – currently in the process of acquiring Monsanto; **International Flavors and Fragrances** – a leading global creator of flavours and fragrances used in the food, beverage, personal care and household products industries; and **SAP**, the global leader in business applications and analytics software.

US & EUROPEAN

equity screen

		Revenue breakdown				12-month forward					
Company name	Country	Europe	US	Rest of world	Market cap (US$bn)	Price earnings ratio	EPS growth	Dividend yield	Dividend cover	Return on capital employed	Net debt/ EBITDA
Alphabet	United States	34%	26%	40%	654	26.3	20%	0.0%	n/a	45.3%	-2.3
Exxon Mobil	United States	33%	46%	21%	322	20.7	40%	4.1%	1.2	10.8%	1.0
Nestle	Switzerland	26%	43%	31%	261	22.1	10%	3.1%	1.5	19.9%	0.6
Procter & Gamble	United States	23%	53%	24%	234	21.9	1%	3.1%	1.6	21.6%	0.9
Pfizer	United States	20%	55%	25%	199	12.5	1%	4.0%	2.0	25.0%	1
MasterCard	United States	21%	45%	34%	147	27.8	16%	0.7%	4.8	210.5%	-0.7
SAP	Germany	36%	40%	23%	126	23.3	9%	1.6%	2.7	20.3%	0.0
Sanofi	France	28%	46%	26%	117	13.7	5%	3.8%	2.0	14.7%	0.6
Bayer	Germany	31%	38%	31%	107	13.9	1%	2.7%	2.8	19.9%	0.8
Siemens AG	Germany	42%	29%	29%	106	13.5	4%	3.5%	2.1	17.1%	1.2
PayPal	United States	22%	58%	20%	74	36.8	20%	0.0%	n/a	41.5%	-3.5
BMW	Germany	47%	21%	32%	62	7.1	4%	4.8%	2.9	21.8%	-0.5
Henkel	Germany	46%	28%	26%	58	18.6	6%	1.7%	3.1	19.2%	0.1
AP Moller-Maersk	Denmark	22%	53%	25%	43	20.7	55%	1.9%	2.6	6.3%	1.6
Pandora	Denmark	41%	34%	26%	11	10.5	12%	5.8%	1.6	87.1%	0.2
International F & F	United States	24%	41%	35%	11	22.5	11%	2.0%	2.2	23.0%	1.1

Source: Quest®

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These figures above are shown in US dollars. These returns may differ significantly when converted to other currencies at the prevailing exchange rates. Past performance and future forecast figures are not a reliable indicator of future results.

Cleaning up

Founded in 1837, Procter & Gamble (P&G) is one of the world's oldest and largest household and personal care (HPC) companies. With around 65 brands (including household names such as Pampers, Bounty, Ariel, Head & Shoulders and Oral B), its products are sold in over 180 countries.

Following the financial crisis, P&G seemed to lose its way as sales growth stalled and profit margins declined. While the company was slow to react to the issues it was facing, once it did so the response was emphatic.

First, in 2012, P&G announced a US$10bn cost-saving programme, then in 2013 it reappointed legendary AG Lafley as CEO to help put the company back on track. Under his second term (he has since retired again), P&G set about rationalising and streamlining its business, exiting over 100 non-core brands.

Along the way, P&G has sold some iconic brands (including Duracell) and entire business segments such as food, with the sale of Pringles to Kellogg's and animal pet foods to Mars. Between 2012 and 2016, the company's cost-saving programme delivered in excess of the originally planned US$10bn, with P&G now looking to save a further US$10bn in productivity improvements over the next five years.

The recent results for the year ending 30 June 2017 were yet another encouraging sign that the restructuring is beginning to bear fruit. Sales grew 2% on a constant currency basis, while the operating margin rose just shy of 1% to 20.6%, helping to drive a 6% increase in earnings per share (EPS).

The shares currently trade on 21.9x 12-month forward earnings. And while this is in line with the price-earnings ratio (P/E) for the global household products sector, we believe that P&G has better sales and earnings growth prospects over the medium term than many of its peers, courtesy of the ongoing restructuring drive.

Marc Pullen

Senior Equity Analyst

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Procter & Gamble

Market Cap	US$234bn
Share Price	US$91.9

	2017A	2018F	2019F
Revenue (US$bn)	65.1	67.1	69.1
Earnings per Share (US$)	4.10	4.20	4.40
Dividend per Share (US$)	2.70	2.80	2.90
Dividend Yield	3.1%	3.1%	3.2%
Free Cash Flow Yield	4.6%	4.6%	4.8%
Price Earnings Ratio	21.1	22.0	20.7
Return on Capital Employed	20.4%	21.5%	22.5%

Source: Quest®
Note: 2018 and 2019 are forecast years

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

Banking on financial services

Launched in 2013, Polar Capital Global Financials Trust offers investors a more diversified way to play the recovery in the financial services sector, with a particular focus on listed banks and insurance firms.

Too much negative sentiment continues to weigh on this sector, and the underlying business models of these companies since the crisis have improved. While banks may not be the high-growth entities they once were, they offer a compelling income story. And with significant capital buffers built up thanks to tighter regulatory conditions, they should continue to reward investors via increased dividends.

Currently yielding 3.3%, the trust has a focus on dividend growth, and the underlying portfolio is much more than a play on the MSCI World Financials Index. Key differentiators include:

- More diversified: c.57% of the portfolio is invested in banks, with the remainder spread across diversified financials, insurance, real estate and software services
- Enhanced yield: 8.7% of the trust is invested in fixed income, helping to enhance the yield
- Approach to banks: the portfolio includes those that offer higher growth - which are either in emerging markets or smaller challenger banks in the developed world - as well as those offering good dividend growth which are the larger developed market banks
- Geographic exposure: largest exposure is to the US at 35%, with managers more positive on US banks given the likelihood of rising interest rates. It also has 25% in Continental Europe, 16% in Asia Pacific (excluding Japan), and just 11% in the UK – of which its weighting is geared towards challenger banks such as Virgin Money, Aldermore and OneSavings Bank
- Size: the trust is underweight mega-caps and large-caps and overweight mid-caps, small-caps and micro-caps.

The shares have outperformed over the past 12 months, delivering 37.5% to August 2017, compared with a rise of 30.5% from the MSCI World Financials Index. We see the current discount as a good opportunity to buy.

Patrick Thomas

Investment Manager

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Polar Capital Global Financials Trust

Market Cap	£266m
Share Price	131p
NAV	143p
Premium/(Discount)	(8.4%)

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

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 any other 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 month	3 months	6 months
Ferrexpo	1,741	297	2.7	6.0	2.1	6.5	28%	63%	86%
Sophos Group	2,305	498	3.7	4.1	-264.0	88.9	9%	10%	78%
Hutchison China MediTech	2,237	3,688	0.0	0.0	124.6	-106.8	7%	18%	76%
Wizz Air	2,113	2,915	0.0	0.0	5.1	14.9	12%	24%	74%
Fevertree Drinks	2,804	2,433	6.3	8.7	31.2	71.1	14%	38%	73%
Burford Capital	2,399	1,152	7.4	8.4	7.9	15.3	11%	33%	69%
Kaz Minerals	3,679	824	0.0	0.0	7.2	12.1	18%	63%	56%
NMC Health	5,540	2,712	10.6	15.6	17.7	35.0	20%	24%	55%
SIG	1,030	174	3.7	3.6	13.4	17.9	8%	14%	55%
Countryside Properties	1,562	347	3.4	8.1	15.7	12.9	-3%	4%	55%
Purplebricks Group	1,257	463	0.0	0.0	-142.6	-71.8	-2%	18%	54%
Worldpay	8,288	417	2.0	2.6	28.9	31.9	11%	32%	54%
Sirius Minerals	1,229	28	0.0	0.0	-22.2	-252.6	-8%	-8%	53%
boohoo.com	2,672	233	0.0	0.0	42.5	79.1	0%	10%	52%
Stobart Group	1,011	288	13.5	17.5	-216.8	67.0	4%	5%	52%
Renishaw	3,334	4,580	52.0	56.2	22.8	30.8	10%	24%	49%
Senior	1,125	269	6.6	6.9	14.3	20.0	10%	13%	47%
Intertek	8,071	5,020	62.4	70.4	18.6	26.6	17%	18%	42%
Coats	1,104	79	1.0	1.2	6.6	17.6	0%	6%	42%
Thomas Cook	1,899	124	0.5	0.9	14.4	12.5	16%	34%	42%
3i Group plc	9,167	958	16.0	26.1	4.0	9.7	4%	8%	39%
Berendsen	2,178	1,271	33.0	33.2	18.1	21.8	0%	18%	39%
Paysafe Group	2,835	585	0.0	0.0	12.4	16.0	-1%	18%	38%
Evraz	4,518	316	0.0	22.5	7.5	9.0	34%	61%	37%
Clinigen Group Plc	1,313	1,125	4.0	4.8	19.3	19.5	14%	25%	36%
Coca-Cola HBC	9,575	2,625	37.6	48.3	17.5	24.1	15%	17%	35%
Bovis Homes	1,413	1,050	45.0	45.0	9.4	14.2	5%	16%	35%
Electrocomponents	2,824	637	12.3	13.0	17.3	25.8	3%	9%	34%
Cobham	3,242	136	1.8	0.0	19.0	25.4	2%	-2%	31%
Sports Direct	2,043	387	0.0	0.0	8.0	22.7	5%	30%	30%

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.

Dividend Cover:	A measure of the ability of a company to maintain the level of dividend paid out. It is calculated as normalised earnings divided by the ordinary net dividend.
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, Tax, Depreciation and Amortisation: enables better comparison between companies as it is not affected by the way that the company is financed or by subjective accounting charges for depreciation and amortisation.
Free Cash Flow:	Cash generated after interest, tax and net capital expenditure but before acquisitions, dividends and share issues or buybacks.
Free Cash Flow Yield:	Free cash flow divided by the share price.
Net Asset Value (NAV):	Net asset value (NAV) is value per share of a mutual fund or an exchange-traded fund (ETF) on a specific date or time. With both security types, the per-share dollar amount of the fund is based on the total value of all the securities in its portfolio, any liabilities the fund has and the number of fund shares outstanding.
PEG:	Price earnings ratio divided by EPS growth.
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.
Return on Capital Employed (ROCE):	A measure of a company's profitability and the efficiency with which it uses its capital. It is calculated as operating profit divided by capital employed.
Tables:	F- Forecast results, figures based on the combined estimates of analysts covering the company. A- Actual results, company's published results.

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Investment Recommendation:

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Date and time of production: 04.09.2017 - 10.00AM ET

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 30.08.2017

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