

EQUITY RESEARCH

2015 TOP RECOMMENDATIONS



COLLINS SARRI STATHAM
INVESTMENTS

Research Report

ADVISORY SERVICES

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Analyst

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Collins Sarri Statham
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2015 arrives with a bang

We commence 2015 with a number of residual issues.

*The UK retailers release Christmas updates this week. There are many issues to address, firstly whether new CEO Dave Lewis initiates a “price re-set” that takes Tesco prices down to a level that eliminates the price advantage enjoyed by Lidl and Aldi. Should he take this step that would stabilise Tesco’s market share. Secondly what approach is taken to strengthen Tesco’s balance sheet? We expect asset sales.

*The February/ March earnings season will see the Q4 report for the oil & gas sector, Q4 2014 saw the sharpest quarterly slump in crude oil. BP Q4 could be just 5 cents post \$750m of Rosneft write-offs. Given the BP quarterly dividend is 10 cents this would require BP to draw down reserves.

*May 7th 2015 is the UK General Election. We predict extreme sensitivity ahead of the election which is likely to result in another hung parliament.

*However expectations are low with investors a bit bruised by 2014. Our Top Four Recommendations reflect a conservative, prudent approach.

Bonds start 2015 in the ionosphere

At the start of 2014, bonds were high, they were in the stratosphere. As 2015 starts, to extend the metaphor they have moved to the ionosphere.

Record low bond yields mean attractive refinancing opportunities for corporate borrowers and gains for bond portfolios. The recent bond surge reflects the stance of the US Federal Reserve, and the volatility in commodity and equity prices.

Sovereign Borrower	5 Yr Yield (YTM)	10 Yr Yield (YTM)	10Yr Yield month change
France	0.14%	0.78%	-0.25%
Germany	0.02%	0.50%	-0.28%
Italy	0.84%	1.75%	-0.21%
UK	0.92%	1.72%	-0.30%
USA	0.62%	2.11%	-0.19%

source: www.ft.com

The US Federal Reserve, by promising to be “patient” over rate rises (18 December 2014) notwithstanding 5% US GDP growth led investors to believe a hike in Federal funds could be later in 2015. When questioned about how long “patient” meant, Fed chair Janet Yellen said “at least a couple of Fed meetings” implying Fed funds would not change before April 2015.

The Federal Reserve is concerned over 2014’s geopolitical issues, the slowdown in China and Russia and soft demand in Europe. Slumping oil prices could impact the US recovery via destabilising the US oil and gas sectors and US capital markets.

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Portfolio Particulars – individual equities details

Alliance Trust (ATST) BUY

Alliance Trust is FTSE 250 investment trust that enables holders to own a global blue chip, professionally run diversified portfolio, with strong processes and methodology for stock selection. The trust has an impressive track record, gaining c.60% since August 2008 and is the third largest manager of Sustainable and Responsible Investment funds in the UK.

Company	Alliance Trust
Share Price	469
Target Price	520
52 Wk Hi/Low	481/426
Shares O/S	553.3m
Market Capitalisation	£2.6bn
Avg Daily Volume	87.2k
Dividend Yield	2.09%

Source; Fidessa plc

Key Risks to Price Target

- i) Alliance Trust is subject to changes in equity valuations which impacts net asset value.
- ii) Sensitive to changes in key personnel and the ability to deliver investment performance.
- iii) Subject to investor sentiment towards investment trusts which will impact the share price discount or premium to net asset value per share.

Key Catalysts

The 20th November Analyst Day gave an in depth presentation of the team's approach to stock selection – and the spread of investments which remain weighted towards North America (48.6%), with UK (21.4%) and Europe (19.9%) and Asia/ Emerging markets (10.1%).

Alliance Trust's 12.2% discount to net assets (543.3p/ 31 December 2014) is sizeable and above those of comparable investment trusts such as Bankers Investment Trust.

Old Mutual (OML) BUY

Old Mutual is a FTSE 100 listed life insurer that operates under the Old Mutual brand, holding 51.8% of South Africa's Nedbank and a near 80% stake in Old Mutual Asset Management

Company	Old Mutual
Share Price	185
Target Price	230
52 Wk Hi/Low	209/169
Shares O/S	4.9bn
Market Capitalisation	£9.08bn
Avg Daily Volume	2.4m
Dividend Yield	4.59%

Source; Fidessa plc

Key Risks to Price Target

- i) Old Mutual faces regulatory pressures in the area of pension reform and capital requirements.
- ii) Old Mutual balance sheet is sensitive to movements in the South African Rand and USD.
- iii) Old Mutual's structure with many separate and diverse business subsidiaries makes it harder to predict the performance of the parent company.

Key Catalysts

Ahead of prelims on 27th February we expect an update on recent acquisitions i) Quilter Cheviot (£16bn UK discretionary fund manager acquired for £585m) ii) Nedbank's EcoBank Transnational (\$493m) iii) Intrinsic and Cirilium. Old Mutual's Nedbank reported 8.4% profit growth to ZAR 17bn (end Sept) whilst recently listed Old Mutual Asset Management (Oct 15th \$14 per share) has seen strong inflows.

*Old Mutual should beat EPS forecasts of 19.3p for 2014 (H1 2014 8.8p EPS). The shares are rated on 9.6x forecast earnings.

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Pearson (PSON) BUY

Pearson is the owner of the publishers Financial Times and Penguin Random House, and Pearson Vue, a provider of examination centres. In 2014 it acquired Group Multi for £505m.

Company	Pearson
Share Price	1142
Target Price	1300
52 Wk Hi/Low	1340/998
Shares O/S	819.9m
Market Capitalisation	£9.36bn
Avg Daily Volume	0.75m
Dividend Yield	4.22%

Source; Fidessa plc

Key Catalysts

The board guided investors to expect 62p-67p of adjusted earnings in 2014 – which includes £50m of restructuring expenses. The 2014 prelims are due on the 2nd March 2015.

Pearson should benefit from recent gains in the USD – the near 10 cent decline since mid-2014 will positively impact EPS by around 2.4p. Our expectation is the restructuring and Grupo Multi acquisition will lift the Schools business in 2015.

Key Risks to Price Target

- i) Pearson operates in a highly competitive area for print and digital media in the financial sector
- ii) Pearson net debt at £2bn post acquisition of Grupo Multi (£505m).
- iii) Significant sales (60%) exposure to US and growth challenges in Schools division.

TSB (TSB) BUY

TSB is the UK's seventh largest retail banking group as measured by branch network. It was listed via an IPO of 38.5% of TSB in June 2014 having been demerged from Lloyds Banking Group in September 2013. The TSB business is primarily engaged in personal loans, mortgages and current account banking for retail clients.

Company	TSB
Share Price	278
Target Price	330
52 Wk Hi/Low	297/247
Shares O/S	500m
Market Capitalisation	£1.4bn
Avg Daily Volume	281k
Dividend Yield	0%

Source; Fidessa plc

Key Catalysts

Strong Q3 PBT £33.1m (+28.8%) (against £25.7m in Q2) and net interest margin (361bps+1bp) trends suggest on target 2014 prelims on 25th February and a strong start in 2015. TSB has done well to hold net interest margins at elevated levels relative to its peers. TSB's branch "refresh" programme should be at 260, over half the network by end 2014. TSB should benefit from customer migration from larger banks and key initiatives in broadening its intermediary capabilities.

Key Risks to Price Target

- i) TSB net interest margin is sensitive to mortgage spreads and impairment losses relating to its UK loan book.
- ii) Lloyds retains a 50% stake in TSB and is likely to sell further TSB shares over the next 24 months. This creates an overhang in TSB shares.
- iii) Increasingly UK competitive environment, via new challenger banks, building societies, large UK banks which many impact net interest margin.

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HOLD: The company’s valuation appears to reflect investor expectations in the short-term. Alternatively the company is awaiting key developments that will impact on the share price. Investors are advised to await the resolution of these key developments.

SELL: The company’s valuation appears too high having regard to material uncertainties, declining profit prospects or has sizeable funding requirements. A sell recommendation may also be applied where the board have failed in key objectives or appear to be frequently changing strategy. A sell recommendation means the analyst expects the share to fall to the price target on the note.

NEUTRAL (Not Rated): The analyst does not maintain a view in either direction.

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Please be aware that the following disclosures of Material Interests are relevant to this research note:

Alliance Trust, Old Mutual, Pearson, TSB Relevant disclosures: < 2>

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