Equity Research; 2016 another "Warm winter"

COLLINS SARRI STATHAM INVESTMENTS

Research Report

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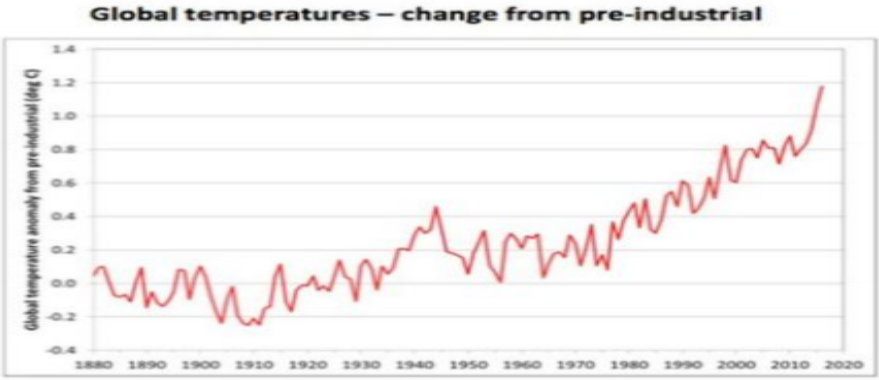
2016 another "warm winter"

We had three consecutive "warm winters". The Met Office predicts another for 2016.

2016 looks like being the warmest year on record globally, with data from the first nine months in, scientists are 90% certain that 2016 will be warmer than the record set in 2015. According to the World Meteorological Office (WMC) temperatures were 1.2°C above pre-industrial levels.



Data: NOAA, NASA, UK Met Office/CRU

Climate change is occurring. It is not "created by the Chinese" according to Donald Trump's Presidential campaign. There are expectations the Trump Administration will dial back on US climate change by withdrawing from the Paris climate change agreement (legal since 4th Nov 2016). The Obama Administration is supportive of the Paris accord – Secretary of State John Kerry following a trip to Antarctica listed ways in which global warming was self-evident, more flooding and higher sea levels. The Artic sea ice and the Greenland ice sheets have melted very early in 2016. It is hoped Obama might convince Trump to keep within the Paris agreement.

A warm winter means i) lower gas revenues/ lower energy consumption and ii) more outdoor/ leisure activities. Since the warm winter phenomenon started in 2013 – Centrica plc (owner of British Gas) shares have halved from 402p (Sept 2013) to 201p. Likewise Gazprom (LSE:OGZD) the EU's largest gas supplier also approximately halved.

Who benefits from warm winters? In our view the main pickups are leisure and travel companies and those geared to outdoor pursuits.

First Group – FTSE 250 – BUY

First Group (UK bus & rail & US/ Canada bus) is a diversified transport group with significant exposure to North American transport via First Student (US school buses), First Transit (transport of workers to remote US/ Canadian oilfields) and Greyhound (long distance US buses) together around two thirds of operating profits. In the UK - First Group operates First Bus and First Rail – recent trends have been for lower revenues of c.2% due to passenger reductions and a cut in UK government subsidies for the TransPennine Express.

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The board reported a better interim result (revenues of £2.56bn + 5.1%) and pre-tax profit of £21.9m – EPS rose to 1.4p up 16.7% -largely due to a jump in operating profits at First Student (£14m v £2m).

Consensus profit estimates; First Group							
Year End	Revenue (£m)	Net Income (£m)	EPS (P)	DPS (P)	P/E (x)	Yield (%)	Share Price (p)
Mar-16	£5,220	£168.3	10.3	0	10.5	0	109
Mar-17	£5,850	£189.5	12.2	1	8.9	0.9	
Mar-18	£5,760	£218.5	13.7	4	7.9	3.67	

Source: Bloomberg

The consensus forecasts envisage revenue and profit growth ahead alongside a return of the dividend (shelved in 2013 after a rights issue 3 for 2 at 85p ps). A return to significant profitability at First Group is helped by very weak levels of sterling.

Company	FGP	**Key Catalysts**
Share Price	111p	Shareholders have had concerns on two points i) First Group's pension deficit (£498m) and ii) overall debt (£1.49bn). On the former point, higher bond yields (since the November US election) will reduce the pension deficit via a higher discount rate.
Target Price	130p	
52 Week Hi/Low	114p/80p	
Shares O/S	1.2bn	
Market Capitalisation	£1.337bn	Brexit has impacted in terms of more UK consumer caution reducing like for like rail passenger growth to (-0.1%). Our expectation is rail travel demand will recover as Brexit uncertainty abates over 2017 encouraged by a mild winter.
Avg. Daily Volume	1.91m	
Dividend Yield	0%	

Source: Fidessa

Key Risks to Price Target

i) Recent tram derailment in Croydon which resulted in the death of seven passengers, might damage First Group relations with Transport for

London.

ii) First Rail margins at 3.7% have been moving lower; key franchise awards will determine profitability going forward.

iii) High debt levels and near term maturating debt and high pension liabilities

Greene King – FTSE 250 – BUY

Based in Bury St Edmonds, Greene King is the UK's largest integrated pub retailer and brewer. It owns or operates 3,035 managed, tenanted, leased and franchised pubs restaurants and hotels including well-known restaurant brands, Hungry Horse, Chef & Brewer, Flaming Grill and Farmhouse Inns. Greene King also owns a leading ale portfolio including Old Speckled Hen, Greene King IPA, Abbot Ale and Belhaven Best. The business owns the freehold to approximately 83% of its pub estate.

In June 2015 Greene King acquired Spirit Pub Co for £774m a UK competitor with a complimentary geographic spread of 1,207 pubs. Greene King has delivered £16.7m of cost synergies against a £12m target in the first year and lifted annual revenues above £2bn. It now expects £35m of cost savings from the Spirit merger. The business divisions i) Greene King Retail ii) Pub Partners and iii) Brewing & Brands are operating in competitive conditions where UK consumers are expecting incentives to draw them in.

Consensus profit estimates; Greene King							
Year End	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)	Share Price (p)
Apr-16	2,073	256.5	54.1	32.1	14.0	4.23	759
Apr-17	2,216	279.8	71.9	33.5	10.5	4.41	
Apr-18	2,255	295.4	76.0	35.4	10.0	4.66	

Source: Bloomberg

The consensus forecast for Greene King is undemanding as the FY17 will include a full contribution from Spirit Pubs alongside possible 2% like for like growth.

Greene King is on a significant ratings discount (PE 14x) to close peer JD Weatherspoon (16.5x PE) despite the similarity of the two businesses.

Company	GNK	**Key Catalysts**
Share Price	758p	Post Brexit the sterling devaluation will increase Euro costs (seafood, beers, wines) etc. Some peer group companies (Restaurant Grp) have reported profit warnings. Greene's most direct competitor JD
Target Price	900p	
52 Week Hi/Low	977p/719p	
Shares O/S	309.83m	

Market Capitalisation	£2.35bn	Weatherspoon reported 3.4% like for like sales growth v 1.7% like for like growth at Greene King. The Spirit acquisition has increased the number of Greene's leasehold properties and net debt (c. £2.05bn). A key challenge is refinancing expensive mortgage type debt into cheaper/ shorter dated loans. We note a new £460m revolving facility and preliminary moves to cut average debt costs of 6.6%.
Avg. Daily Volume	0.79m	
Dividend Yield	4.28%	

Source: Fidessa plc

Key Risks to Price Target

i) Intensifying competition for dining out could hit Greene Kings restaurants

ii) Weak sterling impacts food & wine purchasing costs hence a risk to profits

iii) Greene King's capital structure has significant fixed rate, long dated and securitized bonds – this makes it hard to generate financial savings

Halfords – FTSE 250 – BUY

Halfords is the UK's leading retailer of motoring, cycling and leisure products and a leading independent operator of auto garages for servicing and repairing cars. The business is heavily weighted to cycling retailing (86% revenues) which is experiencing 2.4% like for like sales growth v auto garage growth of c.1% p.a.

After a small decline in cycles demand in 2015, the market has stabilized in 2016 helped by the success of Team GB at the Rio Olympics which cleared unsold inventories. The peak summer period also benefited from warmer weather which continued into the autumn. At Halfords interim results (10th November) the like for like cycling revenue growth was 4.6% doubling from 2015 levels.

Halfords acquired Swansea based Tredz & Wheelies for £18.4m in May 2016 – the business is an online based seller of expensive bicycles, parts and accessories. The Tredz acquisition (0.57x sales and 8x profits) added online capabilities to Halfords largely retail shops base.

Consensus profit estimates; Halfords							
Year End	Revenue (£bn)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)	Share Price (p)

Mar-16	1.02	81.5	33.2	17.0	9.8	5.23%	325
Mar-17	1.08	73.7	30	17.1	10.8		
Mar-18	1.12	74.1	30	17.5	10.8		

Source: Bloomberg

Consensus forecasts for Halfords envisage a decline in profits over Fy17 before recovery in Fy18. These are cautious in our view given interim PBT of £39.1m. A warm winter could boost Xmas trading given promotional activity.

Company	HFD	**Key Catalysts**
Share Price	325p	Halfords retail business is key to its performance, gross margins declined to 47.6% sales in H1 due to higher purchasing costs (weak sterling).
Target Price	400p	
52 Week Hi/Low	449p/305p	Given competitive conditions Halfords is not adding significant new capacity – the portfolio was 472 stores (+2) at 30 September with 311 Autocentres (+4) with a total budget of £40m p.a.
Shares O/S	199.1m	
Market Capitalisation	£639m	
Avg. Daily Volume	0.82m	Halfords inventories (£176.6m) rose from £159m enabling to comfortably meet Xmas demand.
Dividend Yield	5.43%	

Source: Fidessa plc

Key Risks to Price Target

i) Weak sterling v USD has increased input costs; Halfords is attempting mitigation strategies. Their success will determine margin growth

ii) Halfords responsiveness to the volatile cycling market is important in meeting profit forecasts

iii) Halfords Autocentres weak profitability could reduce further on higher lease expenses.

(NB. "PBT"- profit before tax, "EPS" earnings per share, "DPS" dividend per share, "P/E" price to earnings)

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Greene King	**Relevant disclosures:**	**<2>**
Halfords	**Relevant disclosures:**	**<2>**

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