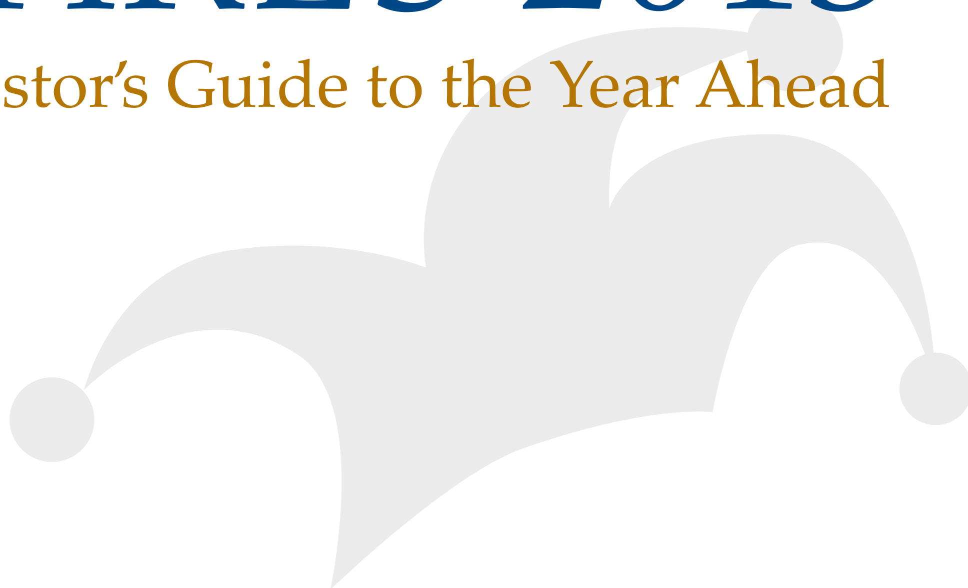
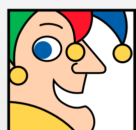
SHARES 2013

The Investor's Guide to the Year Ahead



From The Motley Fool's Top Analysts and Writers



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Introduction

BY STUART WATSON

Dear Fellow Fool,

If you have a pound invested in the stock market, I bet you've played ostrich at least once this past year. You know what I mean: eyes clamped shut, head down, praying it'll all be over soon.

After all, it's ugly out there. A lot of countries have too much debt, economic growth seems non-existent, unemployment is still a major problem, and politicians seem dead-set on driving in circles with the handbrake on. All of this has led to a lot of market volatility. In such turbulent times, it's helpful to keep things simple — and we think that is exactly what gives individual investors like us an advantage over our friends in the City.

KEEPING IT SIMPLE

At The Motley Fool, our investing philosophy has always been simple:

1. We look to invest in good businesses.

2. We hope to own their shares for a while.

These two tenets create a powerful formula that has enabled many Fools to persevere through rough investment climates.

So what exactly do we think qualifies as a "good" business? We think it's companies that consistently add value to their products and services, going above and beyond their competitors' offerings. They have pricing power, and they aggressively defend their turf to keep competitors at bay. Some have assets that are hard to replicate, while others benefit from a strategic head start.

We believe that good businesses, in whatever form, focus on refining their strengths to earn excess profits and drive their value ever higher — and they are the ones that continue to get up off the mat after the market and economy deliver jabs and uppercuts.

When investing in these companies, we Fools think in terms of years, not days, and it's that long-term focus that affords us the courage to invest amid global chaos. A long investing horizon provides a much more reasonable time frame for current economic conditions to work themselves out, and it gives us appropriate context for the severity of the challenges some companies face.

This perspective can also help us take volatility in our stride, as we hope the companies we've selected can navigate market turmoil more skilfully than mediocre ones. When the waters settle, these businesses should be positioned to resume success, and that should translate into superior returns over time.

THE RESULTS

On the pages that follow, we hope you'll find evidence that our investing equation, simple as it may be, has some merit. We've published this report in each of the last three years, and we think the results speak for themselves.

But the real value comes from what our annual exercise means for you: an investing approach that's simple enough to be employed by any Fool, based on buying shares of great companies and taking a long-term ownership mindset, applied year in and year out.

YOUR SHARES FOR 2013 — AND BEYOND

In this report, some of our brightest minds (and your favourite Fools) share 8 timely share ideas that we think present compelling investment opportunities. As you'd expect from The Motley Fool, the line-up is diverse: you'll find young growth companies, dominant stalwarts and turnaround stories.

Despite their differences, we believe each of these companies is a solid business that we feel comfortable owning for the long haul, and we've included buy and sell guidance to help you feel comfortable buying and selling for the right reasons.

Times such as these make it easy to be an ostrich, but we believe they also make it very rewarding to be an engaged investor. We hope this report adds a little simplicity to your investing formula — and a boost to your portfolio.

Foolishly,

Stuart Watson — Premium Services Editor,
The Motley Fool UK.

The Results

SHARES 2010

Company	Price at 5 November 2009	Price at 30 November 2012	Gain/loss
Charlemagne (LSE: CCAP)	17.75p	8p	-54.9%
GlaxoSmithKline (LSE: GSK)	1,220p	1,334.5p	+9.4%
Goodwin (LSE: GDWN)	1,038p	1,610p	+55.1%
Hansard (LSE: HSD)	175p	94.25p	-46.1%
Healthcare Locums (LSE: HLO)	266p	2.18p	-99.2%
National Grid (LSE: NG)	543.8p	705p	+29.7%
Nautical Petroleum *	60.5p	450p	+643.8%
PV Crystalox Solar (LSE: PVSC)	66.15p	9.42p	-85.8%
Tesco (LSE: TSCO)	418.7p	325.1p	-22.4%
Telecom Plus (LSE: TEP)	297.5p	875p	+194.1%
Average			+62.4%
FTSE 100	5,125	5,867	+14.5%

SHARES 2011

Company	Price at 12 November 2010	Price at 30 November 2012	Gain/loss
GKN (LSE: GKN)	175.9p	222p	+26.2%
Halfords (LSE: HFD)	410p	341.2p	-16.8%
McKay Securities (LSE: MCKS)	128p	135p	+5.5%
Mothercare (LSE: MTC)	524.5p	308.75p	-41.1%
NCC (LSE: NCC)	508p	835p	+64.4%
Smith & Nephew (LSE: SN)	594p	657.5p	+10.7%
Velosi *	102.5p	165p	+61.0%
Average			+15.7%
FTSE 100	5,797	5,867	+1.2%

SHARES 2012

Company	Price at 7 February 2012	Price at 30 November 2012	Gain/loss
BAE Systems (LSE: BA.)	318p	327.3p	+2.9%
Camellia (LSE: CAM)	9,900p	9,647.5p	-2.6%
CSF Group (LSE: CFSG)	60p	27.5p	-54.2%
Halma (LSE: HLMA)	371p	436.6p	+17.7%
KCOM (LSE: KCOM)	73p	68.4p	-6.3%
Reckitt Benckiser (LSE: RB.)	3,400p	3,925p	+15.4%
Sports Direct (LSE: SPD)	257p	380.9p	+48.2%
Timeweave *	23p	22p	-4.4%
Average			+2.1%
FTSE 100	5,890	5,867	-0.4%

Notes: In all tables, all share prices are measured mid-price to mid-price and do not include any trading costs. Dividends are not included.
The * symbol denotes that the company has been taken over, and is no longer publicly traded (the takeover price is used to calculate any gain/loss).

Premier Oil: "Solid foundations and big growth potential"

BY ROLAND HEAD

PREMIER OIL

Market: Main (FTSE 250)
Ticker: PMO
Headquarters: London
Website: www.premier-oil.com

FINANCIAL SNAPSHOT

Recent Price:....................336.3p
Market Cap:.................... £1.8bn
Net debt (at 30 Jun 2012) £522m
Data as at 30 Nov 2012

WHAT IT DOES

Premier Oil is an independent oil and gas exploration and production company, with operations in eight countries.

WHY BUY

» Current valuation appears to discount near-term prospects and opportunities.
» Fully funded for drilling commitments, with cash flow boost from a £1bn deferred tax asset.
» Maiden dividend promised.

ABOUT THE COMPANY

Premier Oil (LSE: PMO) was founded in 1934 and listed on the London Stock Exchange in 1936, giving it a continuous 78-year history of exploration, development and production.

It was the North Sea oil boom of the 1970s that proved to be the launching pad for significant growth for Premier. It made several big discoveries in the 1980s and 1990s, not only in the North Sea but further afield in Pakistan and Myanmar as well.

Today, Premier has operations in eight countries, production of 60,000 barrels of oil equivalent per day (boepd), and 2.7 billion boe of unrisked prospective resources (this is an estimate of the maximum amount of oil and gas likely to be recoverable from its oilfields). I think Premier has a clear plan for near-term production growth, and a number of potentially transformational longer-term opportunities — most significantly a deal to develop the Sea Lion oil discovery near to the Falkland Islands.

INVESTMENT THESIS

I believe that Premier Oil offers all of the ingredients required for a successful oil and gas investment: substantial prospective resources and proven reserves, a clear path to production growth, an attractive valuation and a strong track record of successful discovery and development.

The company's oil and gas production levels rose by about 50% to approximately 60,000 boepd in 2012. Looking ahead, 2013 should see production ramping up from the Huntington and Rochelle oil and gas fields in the North Sea, towards the production target of 75,000 boepd.

While production growth has been slightly slower than expected over the last couple of years, I think that this has presented investors with a good buying opportunity.

Looking beyond 2013, Premier's Catcher and Solan fields in the North Sea should drive production growth towards the 100,000 boepd level, while Premier's substantial gas production assets in Asia provide an attractive level of diversity and could tempt buyers.

Exploration success could help drive its share price upwards, too. Premier has 16 exploration wells planned for 2013, including three key wells targeting 100 million boe of prospective resources.

FINANCIALS AND VALUATION

Premier's core financials look pretty healthy to me, and its cash flow is set to receive a big boost as its production in the North Sea ramps up. What's more, thanks to a £1 billion deferred tax asset, it should not have to pay any UK corporation tax until 2018.

Year ended 31 Dec	2008	2009	2010	2011
Sales (£m)	449	384	488	532
Pre-tax profits (£m)	190	49	64	91
Adjusted eps (p)	16.8	16.1	16.5	20.3
Dividend per share (p)	0	0	0	0

I think that Premier's forward P/E of less than 8, based on analysts' current earnings forecasts of around 43p per share, is unduly harsh, given the upside potential of near-term production growth and exploration success. Although there is some risk of cost overruns or further delays, especially with the Catcher development in the North Sea, the company has a decent track record of development success, and should be able to overcome any problems it faces.

Premier is fully funded for all its existing exploration commitments at an oil price of $85 per barrel, and it has committed to start paying a dividend in 2013, providing an added incentive for holding its shares through any short-term turbulence.

Although Premier does have a fair amount of debt right now, its size and successful track record should mean that it can access the capital markets on reasonable terms. What's more, much of its current debt facilities are unused – at the end of June 2012, Premier had a total of $1.3 billion in cash and undrawn debt, with no debt refinancing required before 2015.

RISKS

Leaving aside the possibility of a serious collapse in oil prices, which I personally think is unlikely, I have little doubt that Premier's $2 billion Falkland Island commitment is the biggest single risk facing the company.

In July 2012, Premier acquired 60% of the Falkland Island licence interests of **Rockhopper Exploration** (LSE: RKH), whose 175 million barrel Sea Lion discovery is the only oil find in Falkland Islands waters to date.

Premier paid $231 million to Rockhopper, and has committed to fund the first $1.8 billion of development work on Sea Lion. First oil is targeted for 2017, and success here could be transformative for the company. However, this is a technically challenging project, which could run heavily over budget and behind schedule, and possibly even divert resources from Premier's other projects.

WHEN I'D SELL

I don't see Premier as a short-term play, but I would consider selling if the company doesn't prove able to deliver planned production growth, or if its exploration programme fails to deliver any material discoveries over the next couple of years.

I would also review my investment thesis if Premier's debt pile rose sharply, and it was forced to borrow on more expensive terms. However, I believe that Premier has long-term hold potential, especially if it is able to establish itself as a regular dividend payer.

Disclosure:

As at 30 November 2012, Roland did not own any shares of Premier Oil.

Sources:

- *Premier Oil Annual reports 2008-2011, exchange rate taken from Morningstar data*
- *Premier Oil Interim Management Statement, 15 November 2012*
- *Premier Oil Investor Presentation, September 2012*
- *Premier Oil Half-Yearly Results 2012*
- *Rockhopper Exploration 12 July 2012: "Farm-out agreement signed with Premier Oil plc"*

Admiral: "High quality at an attractive price"

BY MAYNARD PATON

ADMIRAL

Market: Main (FTSE 100)
Ticker: ADM
Headquarters: Cardiff
Website: www.admiralgroup.co.uk

FINANCIAL SNAPSHOT

Recent Price:........................1,119p
Market Cap:......................... £3bn
Net cash (as at 30 Jun 2012)....... £1.6bn
Data as at 30 Nov 2012

WHAT IT DOES

Admiral is one of the UK's leading car insurers, with three million vehicles insured through its *Admiral*, *Bell*, *Diamond*, *Elephant* and *Gladiator* brands.

WHY BUY

- Top-quality blue chip with good track record.
- Owner-friendly boardroom distributes lucrative dividends.
- Share price hit by slowing growth rate.

ABOUT THE COMPANY

Admiral (LSE: ADM) was established in 1993, and has since emerged as the country's second-largest motor insurer. This FTSE 100 business covers three million UK vehicles through its *Admiral*, *Bell*, *Diamond*, *Elephant* and *Gladiator* brands, as well as a further 385,000 vehicles in Spain, Italy, the US and France.

Admiral joined the stock market during 2004 at 275p per share, and a series of impressive results helped the price breach 1,700p during 2011. However, a slowing growth rate, and a proposed government ban on referral fees for personal injury claims, saw the shares more than halve to around 800p over the period of a few months. The shares mounted a partial recovery in early 2012, but I still think they offer an attractive opportunity for collectors of high-quality blue chips.

INVESTMENT THESIS

Admiral is a straightforward business that offers a solid track record, reasonable long-term prospects, a debt-free balance sheet, no pension burden and shareholder-orientated management.

You'll be impressed by the company's financial history. Turnover was £18 million in 1993, and has since increased every year to surpass £2 billion by 2011. Since 2001, Admiral's stated profits have zoomed from £31 million to beyond £300 million.

Particularly encouraging is the fact this expansion has occurred without any acquisition activity. Instead, the company has pioneered various developments in-house, with the creation of the industry's first website occurring in 1995, and the launch of the sector's first comparison website, confused.com, during 2002.

After joining the stock market, Admiral has since rewarded investors with an illustrious series of ordinary and special dividends. Between 2005 and 20011, the ordinary payout was lifted from 10p to 37p per share – equivalent to a 17% average compound growth rate – while every payment was accompanied by a special dividend.

Indeed, lucky investors have collected ordinary dividends totalling 127p per share and special dividends totalling 133p per share since the flotation.

The generous payments stem from the group's entrepreneurial management. Both the chief executive and chief operations officer are founder directors, and have amassed an aggregate 18%/£535m shareholding. They also earn relatively modest salaries, do not collect bonuses, do not receive company pension contributions, and do not own options.

Clearly, their income is dominated by the dividends that ordinary investors also receive – a combined £40 million a year at present. Furthermore, both men are in their fifties, and therefore have time on their side to build the business further.

Admiral's chief exec remains refreshingly free of business-speak, too. You may wish to read his statements within the company's reports, if you are fed up with the waffle most FTSE 100 executives reel off.

FINANCIALS AND VALUATION

Admiral's shares look attractively valued, given the company's progress to date. Half-year results published in August showed profits up 7%, and the current City consensus is for 2012 earnings to improve 11% to 91p per share.

Forecasts for 2013 suggest earnings could improve a further 5% to 96p per share. This latter projection puts the shares on a modest potential P/E of between 11 and 12 – roughly in line with the FTSE 100 average.

Year ended 31 Dec	2008	2009	2010	2011
Sales (£m)	910	1,077	1,585	2,190
Pre-tax profits (£m)	202	216	266	299
Adjusted eps (pence)	55	59	72	82
Dividend per share (pence)	53	58	68	76

August's half-year figures also showed the total interim ordinary/special dividend lifted 15%, leaving the trailing 82p per share payout to support a welcome 7%-plus yield. The current consensus among brokers suggests the 2012 payout may be 85p per share, and the 2013 payout may be 90p per share.

RISKS

An update released during November indicated Admiral's terrific growth record may have stalled.

The firm admitted July, August and September had seen total turnover decrease by 2%, and UK car insurance turnover decline by 5%. Admiral claimed the UK car insurance market was "in the softer part of the cycle" and believed "the sensible strategy… is to slow our rate of growth".

Admiral's slowing expansion coincides with various unfavourable sector developments, at least for the insurers. Last year, Admiral owned up to rising personal-injury claims, and there is a chance the firm's profitable underwriting ratios may not be as profitable in the future.

In addition, the legislation from April 2013 that bans personal-injury referral fees looks set to hurt Admiral's profits. The firm currently earns £7 per insured vehicle from such fees, which means income of £21 million could disappear within the next few months.

Finally, Admiral has had mixed results with its overseas expansion. The international division racked up a £9 million loss during the first half of 2012, and only the Spanish insurance operation is currently profitable. Indeed, various difficulties prompted Admiral to abandon a German venture after three years, and an Italian comparison website after two years. So there is the chance the overseas operations could prove a costly distraction to the wider group's progress.

WHEN I'D SELL

With the aforementioned risks appearing temporary in nature, the major sell signal has to come from the boardroom. In short, if the 'thin cat' executives ever step down, investors ought to consider their exit as well.

Basically, there's little point staying the course when the founders themselves decide it is time to do something else! Admiral's success has been founded on the board's common-sense approach and dividend focus, and it is unlikely a 'hired hand' – especially from outside the business – is likely to have the same affinity with shareholders.

Disclosure:

As of 30 November 2012, Maynard did not own any shares of Admiral.

Sources:

… *Admiral corporate website*

… *Admiral annual reports*

… *Bloomberg*

Tasty:
"The next great restaurant chain?"

BY OWAIN BENNALLACK

TASTY

Market: AIM
Ticker: TAST
Headquarters: London
Website:
www.dimt.co.uk/investor-relations

FINANCIAL SNAPSHOT

Recent Price:........................ 53p
Market Cap:........................£25m
Net cash (as at 1 Jul 2012).......... £0.5m
Data as at 30 Nov 2012

WHAT IT DOES

Tasty is a restaurant group that owns and operates two chains of accessibly priced eateries: Wildwood, which focuses on Italian food, and the Asian-themed Dim T.

WHY BUY

» Wildwood format seems to be working and ready for rollout.
» Growth and profits during a downturn bode well for better times.
» Ride alongside proven entrepreneurs.

ABOUT THE COMPANY

Tasty (LSE: TAST) – a small-cap restaurant group – was founded in 2003 and floated in 2006. The subsequent ups and downs of its share price have mirrored the company's initially meandering showing on the high street, as it de-emphasised its Asian Dim T restaurants in favour of a seemingly more successful Italian format, Wildwood.

So far, so unappetising – but wait until you try out the missing ingredient!

Tasty is another venture from a savvy restaurant clan, the Kaye family:

… Starting in the 1950s, the first generation – brothers Philip and Reginald – hoisted Wimpy, Deep Pan Pizza and Garfunkel fascias across UK city centres.

… Their sons, Adam and Sam, delivered a roughly ten-times return for early investors with their ASK pizza chain.

… Nephew Jonathan Kaye also achieved 'multi-bagging' returns with the restaurant group **Prezzo** (LSE: PRZ).

It's been a tough few years to run a restaurant – let alone a start-up group listed on the stock market – but I'm betting the Kaye family touch is good for another lucrative outcome with Tasty.

INVESTMENT THESIS

If you're Richard Branson or a denizen of Dragon's Den, you're probably regularly offered deals involving the best entrepreneurs in the business. Us little guys are too often served the crumbs of opportunity.

But when investing in Tasty, we can run our money alongside proven entrepreneurs who have millions of pounds invested in the same venture as us.

Tasty's restaurant portfolio is still sufficiently small to believe the best growth could be yet to come, and with Wildwood it now has a successful format. This makes a rollout less of a gamble, and more a matter of executing on its expansion.

Given the founders' track record, I see strong reasons for confidence – and with Sam, Adam, Jonathan and Philip Kaye owning well over 40% of Tasty between them, they've every reason to want to succeed.

FINANCIALS AND VALUATION

Tasty's initial shareholders – including the Kayes – saw the share price crash, as the company reported annual losses and their Dim T restaurants failed to catch on.

Since 2010, though, the company has been reporting a profit, after the Kayes returned to the family speciality – Italian food. Now 14 out of Tasty's 22 restaurants are Wildwood branded.

The pre-opening costs from the last tranche of four restaurants weighed heavily on the recent half-year results. But the potential is clear: given the success of ASK

and Prezzo, I can imagine 100 Wildwood restaurants, potentially generating earnings of, say, 30p a share.

Year ended 31 Dec	2008	2009	2010	2011
Sales (£m)	8.0	9.2	10.6	14.6
Pre-tax profits (£m)	(1.7)	(2.1)	0.2	1.1
Adjusted eps (pence)	(4.8)	(5.5)	0.6	2.6
Dividend per share (pence)	0	0	0	0

However, the one-off costs of opening new restaurants, and the haphazard pace of expansion, makes today's valuation difficult. With little to work on, short-term forecasts amount to guesswork.

On a trailing basis, the P/E multiple has come down to around 20 times last year's earnings, but that's a poor guide to Tasty's potential. A further variable is the capital raising that is likely to be required to fund expansion (though it recently secured a £2.5 million bank loan, which should do for now). A discounted cash flow model could yield a wide range of fair values, depending on where you pitch Tasty's final size, and how much money you think it needs to get there.

At the risk of sounding defeatist on that, I'm betting that as the Kayes have invested their own millions and are used to outsized returns, they see great potential, but beyond that we'll have to embrace uncertainty.

The shares don't seem outlandishly expensive on 2011's earnings – and they're very close to the 52p they listed at six years ago – but buying is a leap of faith.

RISKS

Tasty is likely to need more funds to take Wildwood nationwide. Some expansion can be funded from reinvested profits, but the company may need to be of sufficient scale before self-generated cash flows can really deliver a steady stream of new restaurants. Until then, Tasty could either issue more shares to raise cash (raising the spectre of excessive dilution), or take on more debt (which has its own risks).

Given that Tasty has grown slowly through a five-year on/off downturn, I'm ambivalent about the economic climate. But keep an eye on Tasty's larger listed rivals for any signs of a sharpening deterioration on the high street.

There may be a question mark over how many pizza restaurant chains the UK needs. Given that Wildwood has found a niche in the especially crowded South East, I'm inclined to assume the answer is "at least one more".

WHEN I'D SELL

Since I'm investing in the Kaye family, I would re-evaluate immediately if they left the scene. With luck, they'll eventually exit the company via a richly priced trade sale!

To a lesser extent, I'd be concerned if any Kayes sold down their shareholdings (recently, they've been buying).

I believe Tasty needs to keep growing to deliver the rewards I'm hoping for, so any hint that the managers see Tasty as a lifestyle business would be a concern.

I'd not like to see the company rushing, mind. From previous experience with bungled restaurant rollouts, I'd be especially concerned if Tasty bought a rival for instant scale.

Disclosure:

As of 30 November 2012, Owain owned shares in Tasty.

Sources:

… *Tasty annual reports*

Moss Bros: "A turnaround with a touch of class"

BY NATE WEISSHAAR

MOSS BROS

Market: Main (FTSE Fledging)
Ticker: MOSB
Headquarters: London
Website: www.mossbros.co.uk

FINANCIAL SNAPSHOT

Recent Price:......................58.25p
Market Cap:........................£55m
Net cash (as at 28 Jul 2012).........£26m
Data as at 30 Nov 2012

WHAT IT DOES

Moss Bros is one of the largest formal attire hire and suit retail brands in the UK.

WHY BUY

- A turnaround story that is showing signs of success.
- Debt-free balance sheet and undemanding valuation.
- Recently re-instated its dividend.

Despite my oft repeated claims that the clothes don't make the man, I have worn a suit at nearly every important event in my life. As a result of my stance on fancy clothing, quite often the suit wasn't my own. Therefore, I am the perfect man in the eyes of **Moss Bros** (LSE: MOSB), the UK's leading suit hire operation.

ABOUT THE COMPANY

Moss Bros has been selling suits since 1851, and hiring them out since 1897. The company started with two stores in Covent Garden, but today boasts a network of 136 stores across the UK. Importantly, 131 of those stores include a Moss Bros Hire store within a store.

Selling high fashion is all well and good, but by offering a nationwide network of shops where those of us without a formal wardrobe can get suited and booted for a wedding or to crash Royal Ascot, Moss Bros is able to generate a steady flow of high-margin business to support the more fickle sales of formalwear.

INVESTMENT THESIS

It has been a tumultuous several years for Moss Bros and its shareholders, but I think the company is currently on its way to becoming a successful turnaround story. The balance sheet has been cleaned up, profitability has been restored and the dividend has been reinstated. This may sound like the story is already over, but I think there are still pages to be written – and profits to be had.

FINANCIALS AND VALUATION

As we can see from the table, Moss Bros historical numbers don't look all that impressive, but then again a turnaround needs somewhere from which to turn around. Importantly, at nine times operating cash flow, the shares still appear to be priced for the pre-turnaround performance.

Year ended 31 Jan	2009	2010	2011	2012
Sales (£m)	129.7	128.7	87.8	101.2
Pre-tax profits (£m)	(5.0)	(3.9)	(5.8)	0.9
Adjusted eps (pence)	(9.5)	(6.1)	(5.2)	1.5
Dividend per share (pence)	0	0	0	0.4

Chairwoman Debbie Hewitt and CEO Brian Brick have been in charge since 2009, and have been working to put the company on a path to success. In the past two years, they have sold the company's Hugo Boss and Cecil Gee stores, resulting in an impressive £26 million net cash position, and giving management the ability to focus on improving the Moss Bros operations.

These efforts have been paying off. After streamlining its supply chain and trimming the workforce, gross margins have improved from 53% in 2009 to nearly 60% last year. Fiscal 2012 was also the first in which Moss Bros was profitable since 2007. Along with improving margins and the return to profitability, the company's cash flow has grown nicely.

While I don't expect the gross margin improvement to be replicated going forward, there seem to be plenty of easy opportunities for Moss Bros to grow sales – including the recently launched Moss Bespoke chain of stores, as well as continued investment in improving store appearances and upgrading the online shopping experience. This should help improve operating margins and keep cash flowing in.

Assuming management can cost-effectively upgrade the offering, and grow revenue slightly above inflation, I think operating margins and cash flow should continue to improve, and the shares are worth at least 75p.

RISKS

While I think there are several easy opportunities for Moss Bros to build out its position in the formalwear and formal hire business, there are plenty of threats to my thesis. Any time you attempt to upgrade your supply chain and internal systems, you face execution risk – just ask **SuperGroup** (LSE: SGP). Additionally, while management is taking a cautious approach to its store refurbishments and the Moss Bespoke build-out, there is the risk that capital is misallocated to the detriment of shareholders.

In its latest report, Moss Bros reported weaker gross margins because of rising raw material costs. Input costs and price competition are two big risks facing anyone in the clothing industry, especially in these days of austerity.

Along those lines, a long-term cultural shift away from formal activities could reduce demand for Moss Bros Hire's services, and stunt the growth opportunities for Moss Bespoke and the other retail operations.

WHEN I'D SELL

As this is a turnaround story, there are a few scenarios in which I would sell. First, if the market starts to believe in the turnaround success and re-rates the shares I would be looking to exit. This isn't the most Foolish sentiment, but retail is a cutthroat game, and once the low-hanging fruit I see available to Moss Bros is gone, I'll be looking for the door. I'd also look to sell if Brian Brick were to leave unexpectedly, or we failed to see the current momentum maintained and the turnaround failed to materialise.

Disclosure:

As of 30 November 2012, Nate did not own any shares of Moss Bros, or any other company mentioned in this article.

Sources:

… *Moss Bros corporate website*

… *Moss Bros 2009 and 2012 annual reports*

… *Moss Bros 2012/13 interim report*

… *Capital IQ*

National Grid: "Power up your portfolio"

BY JAMES EARLY

NATIONAL GRID

Market: Main (FTSE 100)
Ticker: NG.
Headquarters: London
Website: www.nationalgrid.com

FINANCIAL SNAPSHOT

Recent Price: 705p
Market Cap: £25.7bn
Net debt (as at 30 Sep 2012) £22.7bn
Data as at 30 Nov 2012

WHAT IT DOES

National Grid's wires and pipes transmit nearly all the electricity and natural gas in the UK. It also owns transmission and generation assets in the north-eastern US.

WHY BUY

» Stable dividend and consistent cash flows.
» Appears undervalued.
» Growth catalyst in the form of ageing power infrastructure grid that needs replacing.

Looking for a steady business? **National Grid** (LSE: NG.) may have it. True, it's not the flashiest, or most original share on the block. But I think it's as close to trustworthy as we are likely to get in the stock market – which is something we can all appreciate right now.

National Grid's business is painfully simple: transmit energy. Everybody needs electricity, and possibly gas, and once you have it coming to your house, you're not giving it up.

Thanks to ageing power infrastructure in both the US and UK, its business should not only be around as long as we've got human civilisation, but should grow in the years ahead. That could result in both capital gains, and continued growth in National Grid's current 5.6% payout for shareholders buying today.

ABOUT THE COMPANY

Although National Grid's assets have long been in existence, the company was officially created in 1990 with the privatisation of the electricity industry. It owns the lion's share of "midstream" electric transmission wires and natural gas pipes in the UK and, following a 2007 acquisition, some US transmission assets, along with some power plants in the north-eastern US. Add in some smaller pieces, like liquid natural gas assets and a metering business, and you've about got it.

National Grid's turnover is split roughly 50/50 between the US and UK, but the latter provides about 60% of operating profits. And from a different angle, roughly 65% of its profits come from electricity, and 35% from gas. Having two profit channels makes the company a bit steadier, in my view.

INVESTMENT THESIS

In the simplest terms, the need for National Grid's power infrastructure should grow over time as the world becomes more developed – this is why I believe its business is an extremely consistent one, known for paying stable dividends.

For those less familiar with utilities, two things are paramount from an investment perspective: demographic growth and regulatory relations. National Grid's service areas don't sport rapid population growth, but the need for transmission infrastructure replacement over the next decade or so makes up a bit for that.

Regulators usually allow companies like National Grid to earn close to "locked in" returns, which removes the potential for both massive reward and, hopefully, massive risk. But as you'd expect, it's imperative that utilities lock in acceptable rates.

An investment thesis for National Grid can be summed up in three points:

1. National Grid's "middleman" positioning puts it in a nice spot with regulators, who tend to be stricter with public-facing distribution utilities that actually

serve customers. Customer ire is far less directed towards out-of-sight transmission operators.

2. National Grid is often able to earn a percentage point or so above the base level of allowed returns by meeting operating performance targets.
3. National Grid plans to invest tens of billions of pounds over the next decade in infrastructure, on which it should earn returns.

FINANCIALS AND VALUATION

National Grid is tailor-made for valuation by discounting profits after taxes, which is a wonderful methodology for such plain-vanilla companies.

City analysts are projecting annual profits growth in excess of 4% per annum over the next half-decade, but I model a more staid 2.7%, tapering down to 2.5%. A 10.3% cost of equity is appropriate I think, although perhaps a little stiff, for the risk the company faces. All said, my model returns a value of 850p per share.

Year ended 31 Mar	2009	2010	2011	2012
Sales (£bn)	15.7	14.0	14.3	13.8
Pre-tax profits (£bn)	2.8	3.1	3.8	3.6
Adjusted eps (pence)	43.3	49.5	51.7	51.3
Dividend per share (pence)	35.6	38.5	36.4	39.3

National Grid had recently been providing 8% yearly dividend increases, but switched to 4% most recently owing to regulatory uncertainties at the time. I'm fine with this, and note that even at 4% per annum, its dividend is still growing faster than the overall economy right now.

RISKS

I reckon that National Grid's primary risk is unfavourable allowed returns. The UK, which sets rates that move with inflation, has traditionally been among the more generous regimes. That said, National Grid is currently tussling with Ofgem about allowed spending programmes over the next eight years, and while predicting the final outcome is impossible, should the new rates force the company to lower its dividend, we may wish to reconsider our position.

The US, which does not adjust its rates to inflation, is still largely benevolent, save for a few regions. Unfortunately, one of those less-friendly US regions (just in a regulatory sense!) happens to be the north-east, where its business is.

Several of its projects in the north-east US are struggling to meet allowed returns, which are already capped below the averages for the US utility industry writ large. Separate from regulations, an economic slump could reduce power usage, and make regulators less keen on allowing generous returns to utilities.

WHEN I'D SELL

I'm not a fan of selling companies like National Grid at the drop of a hat. So barring standard fare, like a scandal or massive overvaluation, I'd mainly grow concerned if a major shift in either of its regulatory environments were to paint a suddenly bleak profit picture moving forward. In other words, regulation is paramount. That said, I'd consider drastically unfavourable changes unlikely.

Disclosure:

As of 30 November 2012, James did not own any shares of National Grid.

Sources:

… 2010 and 2011 annual reports

… Capital IQ

… Morningstar

… National Grid corporate website

Invensys: “Profits from emerging market growth”

BY CHARLY TRAVERS

INVENSYS

Market: Main (FTSE 250)
Ticker: ISYS
Headquarters: London
Website: www.invensys.com

FINANCIAL SNAPSHOT

Recent Price:......................315.5p
Market Cap:..................... £2.6bn
Net cash (as at 30 Sep 2012)....... £175m
Data as at 30 Nov 2012

WHAT IT DOES

Invensys develops software and equipment that improves the safety and efficiency of industrial facilities.

WHY BUY

» Invensys has facilities in more than 50 countries, and should benefit from economic growth in emerging markets.
» It provides key software and equipment to make industrial businesses safer and more efficient.
» Can create value through the consolidation of smaller industrial software firms.

ABOUT THE COMPANY

Invensys (LSE: ISYS) provides software and equipment that is used by more than 40,000 customers around the world. Its products enable 20% of the world’s electricity generation, 17% of global oil refining and 24% of chemical production.

Invensys’ software allows these industrial customers to monitor the operations of their facilities in real time. The client can optimise their production, improve their supply chain efficiency and predict when equipment maintenance should be performed.

The company’s software offerings are the fastest growing and highest margin products it sells. There are significant growth opportunities for the company, in my view, and in the coming year it hopes to pursue oil refineries and the global oil companies with its new software offerings.

INVESTMENT THESIS

Invensys is undergoing a transformation that should make it a far stronger business by next summer than it is today. On 28 November, Invensys announced a proposal for the disposal of its rail business to Siemens for £1.7 billion. The market responded favourably to the proposal, with a substantial re-rating of the shares. Despite the share price gain, I like Invensys even more now for these reasons:

… In agreement with the trustee of the UK Pension Scheme, payments of £625 million should provide a solution to Invensys’ previously underfunded pension scheme, and could remove this liability from its balance sheet.

… The pension contribution eliminates the annual contributions in excess of £40 million a year, immediately improving Invensys’ free cash flow.

… A cash return to shareholders of £625 million is proposed, representing approximately 76p per share.

I respect management’s decision to focus on its industrial software and controls business. In addition to the clear financial benefits derived from disposing of its rail segment, management can now focus their attention on more lucrative opportunities in software.

FINANCIALS AND VALUATION

Year ended 31 Mar	2009	2010	2011	2012
Sales (£m)	2,284	2,243	2,486	2,539
Pre-tax profits (£m)	165	179	222	140
Adjusted eps (pence)	14.1	13.4	19.8	13.4
Dividend per share (pence)	1.5	3.0	4.0	4.4

Invensys’ sales have grown at an annual rate of 3.5% over the past three years. Profit turned down in 2012, due to higher cost of goods sold, and a £56 million exceptional charge that included restructuring costs and asset impairments.

In 2012, the rail group generated sales of £775 million and pre-tax profit of £116 million, and those results need to be subtracted from to get a better picture of Invensys' potential. However, Invensys expects to save £25 million from personnel reductions, in addition to the £40 million pension savings mentioned earlier.

By my estimates, Invensys could generate pre-tax profit of £280 million in three years time from its retained software and systems business, assuming 12% revenue growth rate, and low double-digit operating margins. That would suggest earnings per share of 27p, at a 22% tax rate and a share count of 813 million. At 15 times earnings, which is where the shares have been rated, on average, over the past three years, that would imply a valuation of 405p.

Invensys' fair value is likely to vary, depending on how well the company executes on its strategy to consolidate the industrial software market. If it can acquire strategic products and companies at attractive prices, management could create significant value for shareholders.

RISKS

Invensys must innovate and keep pace with competitors that are also striving to improve their own product offerings. It has invested over £90 million in R&D in each of the last four years, so that it can keep offering world-class technology to its customers.

Invensys has made numerous small acquisitions over the past five years. It has now stated that it wants to consolidate the fragmented industrial software market. While this presents opportunities for growth, it also introduces risks, with respect to integrating other companies' technology and corporate culture. It is also possible Invensys might overpay for any acquired companies.

WHEN I'D SELL

I endorse Invensys' growth by acquisition strategy in its software market, but I would be wary of any acquisition that is of a size greater than 10% of Invensys' market cap (so, around £250 million). The integration risks for large acquisitions are too high for my tastes. I would consider selling after any large acquisition, and watch the progress of the merger before deciding whether to buy back in again.

Invensys shares have been on a tear since the announcement of the disposal of the rail operations to Siemens. If the market continues to admire these shares, I may also look to sell, unless there are additional changes to the business that would lead me to raise my estimate of what they are worth.

Disclosure:

As of 30 November 2012, Charly did not own any shares of Invensys, or any other company mentioned.

Sources:

… *Press releases and corporate presentations from the Invensys corporate website relating to the disposal of the rail division*

… *Invensys 2012 annual report*

… *Capital IQ*

McDonald's Corp: "Why I'm loving it, and you should, too!"

BY NATHAN PARMELEE

McDONALD'S CORP

Market: NYSE
Ticker: MCD
Headquarters: Oak Brook, Illinois, USA
Website: www.mcdonalds.com

FINANCIAL SNAPSHOT

Recent Price:......................$87.04
Market Cap:..................... $87.4bn
Net debt (as at 30 Sep 2012) $11.1bn
Data as at 30 Nov 2012

WHAT IT DOES

McDonald's is the world's leading fast food restaurant franchise, with approximately 34,000 restaurants in 120 countries.

WHY BUY

» Shares have pulled back from their recent highs and look reasonably valued.
» Long-term growth prospects seem to be abundant.
» Dividend yield of 3.6%, and the payout should continue to grow along with profits.

ABOUT THE COMPANY

When I was young, my parents often discussed dinner options by spelling them aloud, hoping my brother and I wouldn't get riled up about them. That's probably why p-i-z-z-a and m-c-d-o-n-a-l-d-s were among two of the first words I learned to spell.

The Happy Meal was a relatively new offering for **McDonalds** (NYSE: MCD) then. It's more than 30 years old now and it's just one of the many hits the company has created since Ray Kroc first franchised what is now the world's best-known burger chain, some 57 years ago.

What started with a single burger stand in California, is now a global empire with more than 34,000 restaurants. Recently, McDonald's has been adding 1,200 to 1,300 new restaurants per year, as expansion in Asia, Europe and Latin America has picked up.

The key to that expansion has been consistency. Ralph Waldo Emerson quipped, "A foolish consistency is the hobgoblin of little minds," and McDonald's apparently took this to heart. If you walk into a new McDonald's in the UK, US, China, Japan, or anywhere else in the world, you'll find cheeseburgers, Big Macs and McNuggets are on every menu, and they taste remarkably similar. But each country is allowed a certain amount of freedom to innovate locally, which is why you'll find sweet tea in southern US states, bubble tea in China and McBites chicken snacks in Australia.

The success in developing and marketing new products globally makes me confident the company can continue to flourish for a number of years, as it continues to expand.

Leading such a diverse global restaurant business requires a deep management team, and I think McDonald's scores well on this front. It's common for McDonald's execs to have earned their stripes making fries, or working the cash register, in one of the company's restaurants. This group includes its chief operating officer, Tim Fenton, who began his McDonald's career as a crew member in a New York restaurant 39 years ago. McDonald's chief executive officer, Don Thompson, started with the company 22 years ago as an electrical engineer.

They're not only skilled, they're also shareholder-focused. Management and the board haven't hesitated to return cash to shareholders. In the past five years, McDonald's has returned more than $27 billion to shareholders through dividends and buybacks, and has boosted its dividend every year since 1976.

INVESTMENT THESIS

In my view, there are multiple growth opportunities remaining for McDonald's globally, including opening new restaurants, improving margins in Asia, and refurbishing existing restaurants. It's these opportunities, along with McDonald's dominant scale and operational excellence, that make up the heart of my thesis.

Refurbishing restaurants – called reimaging by McDonald's – is a bit more than slapping a new coat of paint on the walls. McDonald's has found that moving to

more modern tables, seating, menu boards, and in some cases exteriors, can lead to a big jump in sales. The average US restaurant sees a 6% - 7% improvement in the first year after an overhaul, and one restaurant in California reported a 20% jump. So far, Europe leads the way, with 90% of its restaurants updated, but in the US only 30% of restaurants have been reimaged. I believe that this offers a significant growth opportunity over the next few years in the company's most mature market.

New restaurants can boost growth, too. There are substantial opportunities for new openings in Europe, Asia and the Middle East, and an opportunity to improve margins in these regions as they mature.

Right now, these regions are more growth-focused, and have operating margins that range from 25% to 30%, while the US operating margin comes in above 40%. I think that as these regions mature, margins should gradually move into the 30% - 35% range.

FINANCIALS AND VALUATION

A same-store sale decline of 2% for October 2012 seemed to agitate investors, but I don't see this as an overwhelming reason for concern. This month had one fewer weekend of sales, because of how the calendar fell. Without this, one-off same-store sales would have been closer to flat. With seasonal offerings on the horizon, a renewed focus on the value menu, and McDonald's penchant for new product development, I feel confident the company could be back on a positive same-store sales trend soon enough.

Against this backdrop, McDonald's remains the largest and most dominant operator in the quick-service restaurant space but, as the table below shows, it has become attractively valued relative to its closest peers.

Company	P/E	EV/EBITDA*	P/OCF**
McDonald's	16.4	9.9	12.7
Burger King Worldwide	24.5	13.8	25.3
Yum! Brands	19.7	11.3	13.3

** Enterprise value divided by earnings before interest, taxes, depreciation and amortisation.** Price divided by operating cash flow*

Dividend growth is the final piece of the valuation pie. With a $3.08 dividend payout projected for 2012, McDonald's has more than doubled its dividend in the past five years, and currently yields 3.6%.

Currently, approximately 40% of operating cash flow is paid out as dividends, and I believe the payout should grow with earnings, and perhaps even a little bit faster, as capital expenditure for restaurant refurbishments declines.

Year ended 31 Dec	2008	2009	2010	2011
Sales ($bn)	23.5	22.7	24.1	27.0
Pre-tax profits ($bn)	5.9	6.3	7.0	7.9
Adjusted eps ($)	3.76	4.11	4.58	5.27
Dividend per share ($)	1.63	2.05	2.26	2.53

RISKS

The biggest risk for McDonald's is complacency and, having read through the last few years of reports and conference calls, I don't see signs of too much self-congratulation. Complacency can result in competitors eating away at the substantial competitive advantage that McDonald's enjoys from its scale.

Menu innovation and new product development could slow, which might send customers looking for other options, as health and diet concerns become ever more prevalent. McDonald's added apple slices to Happy Meals, and salads and fruit smoothies to the menu to grow its customer base. As long as the company keeps thinking about getting broader and stays restless, I reckon its scale should keep it ahead of the competition.

As this is a US-based company, there is also additional currency risk with any investment in this company. If the pound strengthens against the US dollar, this could reduce the sterling value of the shares. You may also need to complete a W-8BEN tax declaration before dealing in any US shares, and you may incur additional dealing costs and periodic charges for holding an overseas stock and receiving overseas dividends (these are all things you can check with your stockbroker).

WHEN I'D SELL

I plan on picking up shares in McDonald's as soon as our trading rules allow, and I see very few scenarios where I would look to sell. If, for some reason, competitors were making consistent dents in McDonald's traffic and sales globally, I would be concerned. That said, I would expect that McDonald's scale and renowned test kitchen would allow it to continue evolving, and respond to any competitive threats. So, as long as the cash flow and returns on capital remain high to support the dividend, I'd be willing to ride out any flare-ups from the competition.

Disclosure:

As of 30 November 2012, Nathan did not own any shares of McDonald's, or any other company mentioned in this article.

Sources:

… *McDonalds corporate website*

… *McDonalds 2011 annual report*

… *Capital IQ*

Daily Mail and General Trust: "Hidden value behind the headlines"

BY G A CHESTER

DAILY MAIL AND GENERAL TRUST

Market: Main
Ticker: DMGT
Headquarters: London
Website: www.dmgt.co.uk

FINANCIAL SNAPSHOT

Recent Price:........................ 527p
Market Cap:......................... £2bn
Net debt (as at 30 Sep 2012) £613m
Data as at 30 Nov 2012

WHAT IT DOES

Daily Mail and General Trust is a media conglomerate with an international portfolio of digital, information, news and events businesses.

WHY BUY

» Increasing focus on high-growth, high-margin business sectors.
» Latent value in online operations.
» Good cash generation and healthy-looking balance sheet.

ABOUT THE COMPANY

Daily Mail and General Trust (LSE: DMGT) has been listed on the London Stock Exchange since 1932. Through its Associated Newspapers division, the group publishes the *Daily Mail*, the *Mail on Sunday* and *MailOnline*, as well as urban title *Metro*, which comes in paper, online, smartphone and tablet editions.

DMGT also has a stable of regional newspapers under the Northcliffe Media umbrella. However, Northcliffe is being sold to Local World, a newly formed media group in which DMGT will hold a 39% share.

In addition to its consumer-facing operations, DMGT owns a range of business-to-business (B2B) media assets:

… Risk Management Solutions (RMS), which serves the insurance industry;
… dmg:information;
… dmg:events; and
… **Euromoney Institutional Investor** (LSE: ERM), a £1 billion FTSE 250 company in which DMGT has a 68% stake.

INVESTMENT THESIS

DMGT long ago recognised the challenges and opportunities for newspapers presented by the digital age. One thread of the group's strategy has been to cultivate B2B operations serving diverse industries with a wide international reach. The result is that, excluding Northcliffe, the proportion of DMGT's £274 million operating profit generated from B2B in the most recent financial year was 79%, while 71% came from outside the UK. I expect DMGT's high-growth, high-margin B2B businesses to be great drivers of future profits for the group.

At the same time, cost cutting in the printed newspaper businesses and the announcement of the sale of Northcliffe leave DMGT well positioned with strong national print titles. Print advertising may be heading into a long-term structural decline, but digital revenue from the titles' companion websites is rapidly increasing. In fact, the growth potential of MailOnline – and a couple of other digital businesses sheltering within the Associated Newspapers division – seems considerable.

With a mere £25 million investment to date, MailOnline has already overtaken the website of the *New York Times* to become the most popular newspaper-owned website in the world. It's left BBC News, Fox News and ABC News in its wake, and now has bigger online-only players, such as AOL and MSN, within its sights. MailOnline's annual revenue currently stands at £28 million, and management is looking for £100 million within five years.

We can also expect to see good growth from a digital property business, in which DMGT holds a 52% stake. The business was created recently by the merger of DMGT's findaproperty and primelocation web assets with those of rival Zoopla. Annualised operating profit of the combined group (based on four months of numbers) is around £23 million, and I believe this business can become a credible

challenger to the number one player in the sector, **Rightmove** (LSE: RMV). Rightmove, which has delivered an operating profit of £79 million on revenue of £108m over the past 12 months, is a FTSE 250 company, valued at £1.5bn.

Another promising growth prospect tucked away in Associated Newspapers is Evenbase, a digital recruitment business. Evenbase delivered an operating profit of £11 million this year, but benefited for only part of the year from DMGT's acquisition of the number two global job search engine, Jobrapido.

I think one of DMGT's greatest strengths is its strong cash generation. This has enabled net debt to be reduced from over £1 billion in 2009 to £613 million today, while at the same time supporting dividends, and a payment plan to close the company's pension deficit. DMGT has also just embarked on a share buyback programme of up to £100 million, half of which is covered by cash from the sale of Northcliffe and half from free cash flow.

FINANCIALS AND VALUATION

The table below tells the story of weak advertising sales in printed newspapers, but a strong bounce-back in DMGT's profits since the 2009 low point. I think the real story, though, can be seen in the steadily rising dividend.

Year ended 30 Sep	2009	2010	2011	2012
Sales (£m)	2,062	1,968	1,748	1,747
Pre-tax profits (£m)	(301)	146	126	206
Adjusted eps (pence)	34	46	46	49
Dividend per share (pence)	15	16	17	18

The sales numbers given by DMGT for 2011 and 2012 are as if Northcliffe had already been sold. Going forward, I'm expecting sales to move back towards £2 billion, but with stronger profits on the back of higher margins.

As some of the numbers I bandied about earlier hint at, a sum-of-the-parts valuation of DMGT suggests there could be considerable value in the group that isn't reflected in the share price.

RISKS

The most significant risks I see for DMGT relate to Associated Newspapers. A rapid acceleration in the decline of print advertising revenues, coupled with a failure to increase digital revenues at a matching or higher rate, could derail the company's progress.

The *News of the World* phone-hacking scandal and the recent Leveson Inquiry have focused attention on the policing of newspapers. Increasing regulation of the industry could limit editorial output, and have an adverse commercial impact on the business, while breaches of regulations and defending legal cases could incur significant costs, management time and reputational damage.

Finally, actively managing its portfolio of businesses is an integral part of DMGT's strategy. As such, financial results could be impacted by the failure to integrate acquisitions and, conversely, the failure to achieve optimal value from disposals.

WHEN I'D SELL

While I believe DMGT has an excellent future, if any of the risks I outlined above materialised in what I considered to be a major way, I would not be slow in selling my shares.

Disclosure:

As of 30 November 2012, G A Chester held shares in Daily Mail & General Trust.

Sources:

… Daily Mail & General Trust annual reports

RISK WARNING

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The shares mentioned may not be suitable for any individual.

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ABOUT MOTLEY FOOL SHARES 2013

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