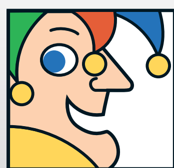
Shares 2014

THE INVESTOR'S GUIDE TO THE YEAR AHEAD



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Introduction

BY MARK ROGERS

Dear Fools,

What a year 2013 turned out to be!

We saw debt limit brinkmanship in the US, the shock resignation of a Pope and political tension around the world. But none of that was enough to stop stock markets around the globe from enjoying healthy advances.

Many pundits have remarked that fear evaporated from the market in 2013. It's hard to disagree — doesn't it feel like a lifetime since we last heard the phrases "Eurozone Crisis" or "Fiscal Cliff"? Lingering worries about the credit crunch, the banks, and even inflation have apparently melted away.

But it's not the buoyant stock market that has us reflecting on a great 2013 — here are just a few highlights from the Fool's last twelve months:

- **The Motley Fool celebrated its 20th birthday.**
- ***Motley Fool Share Advisor* celebrated its first two "double baggers" *.**
- **Our Shares reports have now beaten the market for four years in a row.**

That last point may be of most interest to you right now. In *Shares 2014*, we're aiming for our fifth consecutive year of market-beating returns (you can check out our previous picks for *Shares 2010* through to *Shares 2013* on the next page).

So, what's our secret? And why have our past picks performed so much better than the market?

Well, we don't know of any hidden investing loopholes or shortcuts. As you'll see in this edition, the shares we pick come in all different shapes and sizes — from sturdy powerhouses to tiny, niche manufacturers.

No — our secret, if there is such a thing, is what we think is a simple yet tried and tested approach to investing.

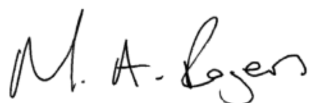
We look for companies that stand out from the crowd. We block out market noise from those worrying about where their share prices might be heading next week. And we look to recommend these companies at a level that we think makes sense as a long-term investment.

In chasing performance, we suspect that many investors get side-tracked, panicked and bamboozled by the stock market's volatile nature. People quickly forget that stocks aren't just wiggly lines on a chart — shares represent an opportunity to buy a piece of a real business.

And over the long haul, your results as an investor should reflect how those businesses perform for you, as a part owner. With that firmly in mind, we think focusing on the business performance is a much smarter approach than second-guessing every up and down in the share price. Focussing on business performance is the foundation of our investment style, even though each of our analysts applies it in their own unique way.

In this report, we have assembled a collection of several Motley Fool investors. Their goal? To present you with seven superior investment ideas for 2014 — and beyond.

You see, while these are primarily ideas for the coming twelve months, our goal is to help you find we believe to be great investments not just for this year, but for years and decades to come.



Mark Rogers - Investment Analyst,
The Motley Fool UK

* The average gain for all Share Advisor recommendations is 26.4% versus 14.9% for the FTSE All-Share Total Return Index. Gains are measured from the closing price on the day of recommendation to either the date of sale or 29 November 2013. Gains for both Share Advisor and the FTSE All-Share include dividends but exclude trading costs. Share Advisor was launched in February 2012, and has recommended two shares each month since that time.

The Story So Far

SHARES 2013

Company	Gain/Loss
Moss Bros (LSE: MOSB)	+27.9%
McDonald's (NYSE: MCD)	+15.5%
National Grid (LSE: NG.)	+13.7%
Invensys (LSE: ISYS)	+28.0%
Tasty (LSE: TAST)	+127.4%
Admiral (LSE: ADM)	+19.8%
Daily Mail & General Trust (LSE: DMGT)	+77.7%
Premier Oil (LSE: PMO)	-6.2%
Average	**+38.0%**
FTSE All-Share	+19.8%

SHARES 2012

Company	Price at 5 November 2009
Sports Direct (LSE: SPD)	+186.7%
Reckitt Benckiser (LSE: RB.)	+55.0%
Halma (LSE: HLMA)	+63.9%
Timeweave (LSE: TMW)	-5.4%
BAE Systems (LSE: BA.)	+50.1%
Camelia (LSE: CAM)	-10.8%
CSF Group (LSE: CSFG)	-84.5%
KCOM (LSE: KCOM)	+48.7%
Average	**+38.0%**
FTSE All-Share	+25.1%

SHARES 2011

Company	Gain/Loss
GKN (LSE: GKN)	+134.9%
Halfords (LSE: HFD)	+45.1%
McKay Securities (LSE: MCKS)	+86.7%
Mothercare (LSE: MTC)	-23.8%
NCC Group (LSE: NCC)	+109.6%
Smith & Nephew (LSE: SN.)	+45.7%
Velosi (LSE: VELO)	+61.0%
Average	**+65.6%**
FTSE All-Share	+32.1%

SHARES 2010

Company	Price at 5 November 2009
PV Crystalox Solar (LSE: PVCS)	-53.8%
Nautical Petrolium (LSE: NPE)	+643.8%
Goodwin (LSE: GDWN)	+257.2%
Charlemagne Capital (LSE: CCAP)	+11.8%
Tesco (LSE: TSCO)	-3.1%
GlaxoSmithKline (LSE: GSK)	+63.5%
Hansard Global (LSE: HSD)	-19.4%
Healthcare Locums (LSE: HLO)	-100%
National Grid (LSE: NG.)	+82.0%
Telecom Plus (LSE: TEP)	+651.3%
Average	**+153.3%**
FTSE All-Share	+55.6%

Notes

- *Shares 2010 starting prices taken at the close of trading on 5 November 2009.*
- *Shares 2011 starting prices taken at the close of trading on 12 November 2010.*
- *Shares 2012 starting prices taken at the close of trading on 7 February 2012.*
- *Shares 2013 starting prices taken at the close of trading on 30 November 2012.*
- *All returns are measured mid-price to mid-price to the close of trading on 29 November 2013, or to when the company was taken over or delisted.*
- *All returns, including the FTSE All-Share, include dividends but no trading costs.*

Reckitt Benckiser: "Household names to underpin your portfolio"

BY MARK ROGERS

RECKITT BENCKISER

Market: Main (FTSE 100)
Ticker: RB.
Headquarters: Slough
Website: www.rb.com

FINANCIAL SNAPSHOT

Recent Price:........................4,909p
Market Cap:..................... £35.6bn
Net debt (at 30 Jun 2013) £2.8bn
Price as at 29 Nov 2013

WHAT IT DOES

Reckitt Benckiser sells household branded consumer products around the world.

WHY BUY

- *Durex, Nurofen* etc fulfil persistent needs of consumers around the globe
- Brands provide pricing power, high margins and "share of mind"
- Potential sale of pharmaceuticals division could focus business and unlock value

ABOUT THE COMPANY

Say the name "Reckitt Benckiser" to most people and you'll probably draw a blank expression.

Mention *Nurofen, Dettol, Strepsils* and *Durex* however, and millions of people around the world should instantly know the products you're talking about – these products are found in many homes across the globe.

Reckitt Benckiser (LSE: RB.), formed when Reckitt & Coleman and Benckiser NV merged in 1999, is the consumer products giant behind those world-class brands. If you're looking to make a great long-term investment in 2014, forget electric cars and complicated gizmos -- I think the most lucrative products of the future could be hiding in our bathroom cabinets today!

INVESTMENT THESIS

Whether we think about it or not, investing is a form of predicting the future. We're looking ahead and forecasting that, for several years at least, a company is going to sell an ever-increasing quantity of its products or services, at prices and margins that generate healthy profits for its shareholders.

For this reason, big brands can be a long-term investor's best friend – unlike most valuable assets, they require little capital expenditure to maintain. Instead of depleting in usefulness each year, the brand becomes more embedded in our lives, and instead can become *more* valuable. Few things command the same kind of protection for consumer demand as a successful brand -- and I think Reckitt's product portfolio is up there with the best.

So as we look for great long-term investments in 2014, and we try to forecast the products that might be in demand in, say, 2040, give me world-class consumer product brands over risky unproven technologies or commodity gambles any day. Those kinds of bets are extraordinarily hard to get right, and the risk versus reward is often poor.

Rather I think investors can do very well by betting on the brands they use every day, which should be sold in greater quantities around the world in the future.

Reckitt Benckiser's brands fit perfectly into this mould. Its products fulfil persistent needs that should need to be addressed for the foreseeable future -- dirty work surfaces, headaches and contraception aren't going away.

Successful brands like *Vanish* and *Air Wick* tend to have remarkable pricing power, enabling Reckitt to increase its prices and achieve lucrative 20%+ profit margins in developed markets. The company generates roughly 40% of its sales from emerging markets -- a proportion that I expect to continue to increase in the coming years.

As Reckitt's brands become more embedded in these markets, and as real wages gradually improve, I think consumers in these regions should buy more and more of Reckitt's branded goods. And as more and more burgeoning consumers grow up with Reckitt's products, I think these markets could be even more lucrative than the UK in the long run.

The market isn't too keen on the 9% of Reckitt's sales derived from pharmaceuticals, where future demand is harder to predict. But with news that the company might sell off this division for £3-5bn, I like the possibility of Reckitt becoming a more focused consumer brand company, while unlocking value for shareholders.

In short, I love the stability, predictability, and economics of Reckitt's business -- and I think it could be the perfect underpinning of a long-term portfolio.

FINANCIALS AND VALUATION

Sadly a business of Reckitt's quality rarely comes cheap. However, in my view, at around 18 times forecast earnings for 2013, Reckitt isn't too expensive either.

I think Reckitt is capable of generating around £2bn in annual cash earnings in its current state. As Reckitt becomes more established in emerging markets and commands higher prices in these regions, I expect its overall margins to gradually improve. This should translate into high single-digit cash flow growth, before tapering off to a steady rate of above-inflation growth.

With that in mind, I'd be willing to value Reckitt's business at between £38-45bn, and place a "fair price" at roughly £55 per share. The current price may not seem like a bargain, but for a company of Reckitt's qualities, it's a price I'm comfortable paying.

Remember, this is a long-term investment idea, so I'd rather be sure of getting an excellent business than squabbling over the last penny.

Year ended 31 Dec	2009	2010	2011	2012
Sales (£m)	7,753	8,453	9,485	9,567
Pre-tax profits (£m)	1,905	2,208	2,463	2,510
Adjusted eps (p)	196	222	237	247
Dividend per share (p)	91	107	120	126

Source: Reckitt Benckiser annual reports

RISKS

As the valuation suggests, Reckitt's attractiveness is no secret to investors. While I would describe Reckitt as having a more stable, predictable business than most companies, it's unlikely to enjoy anything other than sedate sales growth in the future.

That means we're paying a reasonable premium for the quality of Reckitt's business. We need to hope Reckitt lives up to our expectations for steady long-term growth, or investors may have to wait for longer for the investment to pay off.

WHEN I'D SELL

In my view, if bought at a fair price (or purchased over time through pound-cost averaging), Reckitt could be the perfect foundation for your portfolio.

With that in mind, I personally wouldn't be buying Reckitt Benckiser with a view to selling at any time in the foreseeable future.

Naturally, though, I'd be forced to change my mind if Reckitt showed signs that it wasn't capable of allocating capital sensibly in the future -- or if it persistently allowed its brands to fall behind its rivals.

Disclosure:

As of 29 November 2013, Mark did not own shares of Reckitt Benckiser.

TT Electronics : "Accelerating performance and growth"

BY MAYNARD PATON

TT ELECTRONICS

Market: Main (FTSE Smallcap)
Ticker: TTG
Headquarters: Weybridge
Website: www.ttelectronics.com

FINANCIAL SNAPSHOT

Recent Price:........................ 197p
Market Cap:....................... £312m
Net cash (as at 30 Jun 2013)..........£9m
Data as at 29 Nov 2013

WHAT IT DOES

TT electronics designs and manufactures a wide range of specialist sensors, controls, magnetic components and microcircuits for motor, aerospace, defence and medical industries.

WHY BUY

» Exposed to specialist sector with 7% per annum growth prospects.
» Ongoing turnaround could double margins and profits
» Share price offering potential double-digit total returns

ABOUT THE COMPANY

TT electronics (LSE: TTG) can trace its history all the way back to the 1800s, when William Tyzack opened a blacksmiths in Sheffield, and his son-in-law, Benjamin Turner, joined the growing metal works.

Fast forward to the 1980s, and Tyzack and Turner became TT plc following a management buy-out. It then became TT electronics in 2000, when the group started to concentrate on designing and manufacturing electrical components. The business is now best known for supplying specialist sensors and controls for cars.

INVESTMENT THESIS

TT electronics is a turnaround situation that I'm convinced still has some way to go. The group enjoys exposure to what seems to be an attractive growth market, and has plans to raise margins significantly as it looks to cut further costs.

In fact, my sums indicate there is every chance of double-digit total returns during the next five years.

TT's recovery follows a difficult time for the business during the banking crash. A fresh executive team was appointed during 2008 after a profit warning, and had to combat sales dropping 20%, and the group recording a loss during the first half of 2009.

The dividend was scrapped as the company battled with debts, and the share price plunged from 260p to just 20p.

However, profits have since recovered strongly, as the new directors restructured the business towards its sensor and control divisions.

These operations supply sophisticated components for monitoring fuel, emissions, speeds, temperatures, and the all-round performance of motor vehicles -- a market TT reckons could grow at 7% a year, driven by new environmental and efficiency regulations.

The group's products also feature within industrial production lines, automated machining tools, and high-street cash machines.

At the last count, TT's sensors and controls contributed 54% of sales and 70% of profits. The balance of the group's income comes from manufacturing less specialised electronic components, and supplying design and support services.

Although TT has recovered strongly since the banking crash, the company appears confident of further progress. Within August's half-year results, TT said:

"The Board is confident that the focus on Sensing and Control can drive growth and improve overall operating margins to achieve the stated target of 8 to 10 per cent by 2015. The Operational Improvement Plan should underpin this and enable the Group to progress towards sustainable double digit margin performance."

TT has said its Operational Improvement Plan should be implemented during 2014, and could create savings of approximately £8m from the second half of 2015.

Operating margins were 6% during 2012, and were 5% during the first half of 2013, so the potential for "sustainable double-digit margin performance" could see profits surge higher during the years to come.

A trading update in November then confirmed underlying sales during the first ten months of 2013 had gained 3%, with the four months to October experiencing an underlying 8% uplift.

TT did admit, however, that profits for 2013 had been hurt slightly by unforeseen issues arising from restructuring its German division. However, the troubles seem relatively minor, and I don't think they upset the longer-term case for investors.

FINANCIALS AND VALUATION

I'm projecting TT can raise its margins to 11% by 2017. If that is achieved, and sales are sustained at the £500m registered during 2012, profits could be about £41m and earnings per share may reach 26p.

Assuming the shares trade on a reasonable P/E of 12 during 2017, this implies a share price around 310p. Throw in four times the trailing 5.1p per share dividend as well, and we could be looking at a very respectable return from current levels.

True, 11% margins may not be possible. But then again, these sums exclude any sales growth. Predicting 10% margins and 10% total sales growth to £550m for 2017 gives roughly the same level of profits.

Year ended 31 Dec	2009	2010	2011	2012
Sales (£m)	464	556	510	477
Pre-tax profits (£m)	0.8	20.6	24.5	26.7
Adjusted eps (pence)	(1.2)	9.0	11.4	12.6
Dividend per share (pence)	-	2.8	4.4	5.0

Source: TT electronics annual reports

RISKS

Investing in TT comes with several risks.

First and foremost, the upside seems dependent heavily on the group's target to improve margins. If margins don't improve, the present P/E of 16 times trailing earnings may be viewed as too optimistic by the market.

Then there's the chance of making a bungled acquisition. TT has still to turn itself around fully, yet in November confirmed it was "making good progress on acquisition opportunities". Management could be jumping the gun here.

Furthermore, the books carry a £28m pension deficit -- a large sum in light of current profits. TT has agreed to pay additional annual contributions of up to £4.5m up to 2016, and it could be on the hook for more thereafter.

WHEN I'D SELL

The crux of this investment is the margin improvement. Any sign of that being significantly delayed or substantially reduced could prompt an exit. There is -- as yet -- nothing really that special about the underlying business and accounts to warrant keeping the faith with a turnaround extending towards 2020.

Disclosure:

As of 29 November 2013, Maynard did not own shares in TT electronics.

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Cohort: “Gird your portfolio for the future of warfare”

BY NATE WEISSHAAR

COHORT

Market: AIM
Ticker: CHRT
Headquarters: Reading
Website: www.cohortplc.com

FINANCIAL SNAPSHOT

Recent Price:........................218.5p
Market Cap:.........................£89m
Net cash (as at 31 Aug 2013) £11.5m
Data as at 29 Nov 2013

WHAT IT DOES

Cohort is a tiny defence contractor focused on high-tech areas like cyber warfare, security and communications.

WHY BUY

» With budget cuts seemingly everywhere, the defence industry is clearly out of favour with investors, but Cohort's high-tech niche should provide some protection.
» The company's strong balance sheet should allow it to handle a slowdown, while also making acquisitions to bolster its offering and fuel further growth.
» A strong order book and contract win momentum provide some confidence in continued growth over the near term.

Painting with a broad brush makes things easy because the work is done quickly, but it sure does make filling in all the little details a lot harder.

For example, many people know that Western governments are facing significant budgetary issues and defence spending is one of the easy targets, so the easy evaluation is that defence contractors could have a tough go of it going forward.

The so-called gravy train may be ending for companies like **BAE Systems** (LSE: BA.), but with total defence spending of £45 billion last year, there would seem to be plenty of opportunity for a small, technology-focused company like **Cohort** (LSE: CHRT).

ABOUT THE COMPANY

Started in 2006 by a trio of experienced industry hands – Chairman Nick Prest, Co-Chairman Stanley Carter, and CEO Andrew Tomis who between them boast nearly a century of working in the defence industry (not including military service) – Cohort is building its reputation as a supplier of high-tech products and services related to cyber security, monitoring, and communications.

The company was initially made up of defence consultancy SCS – founded by Stanley Carter in 1992. Shortly after listing in 2006, it acquired MASS – a company working to develop secure networks and communications for governments and educational systems – and SEA – a diversified company working on projects from submarine communication networks to communication equipment for satellites.

Cohort's strategy is to acquire companies with promising growth opportunities or intellectual property, and then let the experts at each company to keep doing what they do with minimal interference from head office, so that they can remain dynamic and rapidly respond to a changing industry.

INVESTMENT THESIS

After seeing its shares appreciate over 80% last year, it might seem like it is too late to make a play on Cohort. But I think the company still a good runway in front of it.

The company's focus on high-tech defence applications should put it in a strong position as governments try to make their militaries smarter (and cheaper), and as the threats shift from land, sea, and air to cyberspace. Cohort also has (mostly untapped) opportunities to extend its skills to other sectors (education and industry are current targets).

FINANCIALS AND VALUATION

While Cohort's revenue has been lumpy in recent years, and there have been some struggles at the SCS and SEA subsidiaries, a close look at the table below shows an encouraging improvement in profitability, plus an impressive trend in dividend growth.

Year ended 30 April	2010	2011	2012	2013
Sales (£m)	78	65	75	71
Pre-tax profits (£m)	3.3	3.4	4.2	7.1
Adjusted eps (pence)	5.6	6.8	11.3	17.0
Dividend per share (pence)	2.1	2.4	2.9	3.5

Source: Cohort annual reports. Profits and EPS for 2013 have been adjusted for a £1.4 million non-cash gain.

In addition to strong contract win momentum – Cohort's order book currently stands at £102 million after a string of wins for the SEA and SCS divisions – the company boasts a good-looking balance sheet, backed by £11.5 million in net cash and nearly £9 million in freehold property.

This means investors are currently paying only about £68 million for Cohort's ability to generate £6 million in normalised annual operating cash flows – a number I expect to grow in coming years as the company builds its client list inside and outside the defence industry. That seems like an attractive deal to me, especially when one considers Cohort's history of growing its dividend

RISKS

The obvious risk to my thesis is the company's heavy reliance on one client – the Ministry of Defence here in the UK is the source of over 80% of Cohort's revenue. While I think Cohort's high-tech offerings should provide some protection, there is no guarantee that the company can continue to win contracts.

Additionally, I expect Cohort to grow through acquisition, which is a relatively risky approach. The company has experienced trouble with its SEA subsidiary in the past, and if it were to pay too much for another company, or run into integration issues, it could derail my growth expectations.

WHEN I'D SELL

Cohort's current order book provides decent visibility into revenues for the rest of this year and into next year, but if we were to see evidence that the company was losing its mojo, and the rate of contract wins was to fall off, I'd be re-evaluating this investment.

Secondly, if it became clear that Cohort's management team wasn't able to appropriately allocate our capital – either paying too much for acquisitions, or failing to move the company into growth areas to counteract reductions in government spending – I would consider selling.

Finally, if we were to see problems resurface at the company's existing operations, it would be a black mark on management's ability to handle its subsidiaries, and would cast doubts on the company's operating strategy. This would be a sign that it was time to get out.

Disclosure:

As of 29 November 2013, Nate did not own any shares of Cohort.

Greggs: “Ready to rise”

BY JAMES EARLY

GREGGS

Market: Main (FTSE 250)
Ticker: GRG
Headquarters: Newcastle Upon Tyne
Website: www.greggs.co.uk

FINANCIAL SNAPSHOT

Recent Price:........................442.1p
Market Cap:....................... £449m
Net cash (as at 29 Jun 2013).........£12m
Data as at 29 Nov 2013

WHAT IT DOES

Greggs is the UK’s largest dedicated baker, and is increasingly branching into on-the-go meals and snacks.

WHY BUY

» Its share price and results have languished, but plans are in place for a turnaround that should bring improved results.
» Respectable 4.4% yield comforts investors in the meantime.

Fool, why do you invest? For habit, for sporting fun, for intellectual stimulation, perhaps, but ultimately, you invest to make money.

But here’s a secret: sometimes, the best way to make money is not to invest in “growth” shares. You see, because other investors pile so readily into growth shares, I think such shares can be hard to turn a profit on. Meanwhile, boring, unspectacular companies may offer better rewards, at least according to statistical research.

With soft profits and a languishing share price, **Greggs** (LSE: GRG) is far from growth-y, but with a turnaround plan in place, it sports the sort of potentially lucrative dullness your portfolio may need.

ABOUT THE COMPANY

Founded over 80 years ago, Greggs morphed from a single bakery into the 1,700 or so shops it currently occupies largely through the work of Ian Gregg, the founder’s son. And as Greggs’ product suite grew, it came to dominate the British bakery industry.

INVESTMENT THESIS

For a long time, all was well for this ubiquitous peddler of breads, buns, pastries, coffees, sandwiches, and sugar-laden goodies that leave dentists smiling about their job security.

But just as humanity seeks change in hairstyles, trouser tightness, and dance moves over the years, industries and food preferences change as well.

Greggs has changed with the times to a degree. In 1973, 55% of the company’s turnover was from breads and rolls, whereas now just 5% is (sandwiches, drinks, and savoury goods make up the lion’s share these days).

As customer preferences evolved, and time-strapped customers began purchasing more baked goods through supermarkets (95% today, compared to 91% in 2001, according to industry data that the company cites), Greggs found itself king of a smaller and less popular hill.

To be clear, Greggs didn’t so much fall flat as simply fail to keep pace. The industry has grown over the past five years, while the company’s turnover has remained mostly flat, meaning all the growth has gone to competitors.

The company’s share price – also flat – reflects this. But finally, the truth dawned. The company that only last year was touting plans to add hundreds of shops came upon its epiphany -- more of an unpopular thing is not better.

Perhaps “unpopular” is harsh, but you get the idea – as did Greggs. It bagged plans for big expansion, for an experimental coffee house concept, for international ventures, and decided instead to better its core offering first.

The logic is simple -- on-the-go food is more popular than ever, and Greggs has ample locations, name recognition, infrastructure, and the knowhow to capture a share of this category within the non-premium (i.e., affordable) segment.

So, instead of growth, the company is aiming to revamp (and in some cases relocate) a few hundred stores per year, with expanded seating and a more uniform layout suited to fast dining and take away.

Greggs is adding products like pizza and more sandwiches, launching ordering apps for customers, building its partnership with Moto service areas, and investing in nitty-gritty things like manpower forecasting, and more efficient stocking and ordering systems.

While there's no guarantee that these steps can make Greggs a mega-success, remember that we don't need them to. Greggs had a reasonable enough business base before, so it doesn't need to start from scratch so much as start moving in a better direction.

FINANCIALS AND VALUATION

At the moment, debt-free Greggs is very much washing out its "old" business format, which is still the majority contributor to results. Its most recent first-half turnover rose in total, although like-for-like sales were down 2.9%, with per-share profits down as well.

I think a return to operating profits growth – which should be the eventual result of the company's restructuring – could boost the company's share price nicely. I also like that the company is funding its investment internally. My model returns a valuation of 506p (which you may round up or down as you prefer), which affords a reasonable upside for this dividend-paying investment.

Year ended 31 Jan	2009	2010	2011	2012
Sales (£m)	658	662	701	735
Pre-tax profits (£m)	48	52	53	52
Adjusted eps (pence)	30	33	34	33
Dividend per share (pence)	17	18	19	20

Source: Greggs annual reports

RISKS

Greggs may be doing the right thing in moving heavily into on-the-go foods, but the biggest risk is that it may be late to an already-competitive party.

Similarly, the company's brand may need to be recalibrated slightly in customers' minds, although Greggs' many locations bode well for convenience dining.

And in a smaller sense, whilst we don't like to see companies overuse weather, the economy, and food input price inflation as excuses for performance, these factors do affect results to some degree.

WHEN I'D SELL

The main reason to sell Greggs would be a scenario wherein the company wouldn't be able to secure a strong footing in the convenience meals market, while at the same time was seeing its baked goods business slowly erode from customer loss and purchases being shifted to supermarkets.

That said, I don't see this as the likely scenario, or else I wouldn't be recommending Greggs as a buy today!

Disclosure:

As of 29 November, James did not hold any shares of Greggs.

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J Smart & Co : "A canny opportunity North of the Border"

BY OWAIN BENNALLACK

J SMART & CO

Market: Main (FTSE Fledgling)
Ticker: SMJ
Headquarters: Edinburgh
Website: www.jsmart.co.uk

FINANCIAL SNAPSHOT

Recent Price:........................ 91p
Market Cap:........................£43m
Net cash (as at 31 Jul 2013)......... £5.5m
Data as at 29 Nov 2013

WHAT IT DOES

J Smart is a construction company specialising in commercial and residential property, and has its own real estate portfolio..

WHY BUY

- Net cash and substantial property assets
- Big discount to book value
- Construction outlook should improve as UK economy recovers

ABOUT THE COMPANY

Founded in 1951, **J Smart** (LSE: SMJ) is a family owned and managed construction firm based in Edinburgh. Over the past few decades, it has amassed a relatively substantial real estate portfolio, which it typically builds itself and leases out, in addition to completing work from other companies.

J Smart has not escaped the on/off recession, leading to swings in revenue and profit, although there's less variation in terms of official statements from the company – indeed these can almost seem "cut-and-pasted", with only the numbers changing!

This is not a firm that burdens its shareholders with excessive detail. It's still run by members of the Smart family, and you have to pore through the accounts to get a feel for what's going on.

INVESTMENT THESIS

I believe J Smart is a largely ignored small cap trading at what looks like an attractive discount to its assets.

While construction has proved as cyclical as you'd expect over some very difficult years, J Smart's income from its investment properties has been pretty stable. Before a recent £8m disposal, the value of its properties hovered around the £70m mark for several years. The portfolio is now valued at £62m, and there's over £5m in net cash in the business, too. Consider that J Smart has a market cap of just £43m mark, and you see the investment case in a nutshell.

All in, the accounts indicate a book value of 194p per share, compared to a share price of 91p – a ratio of less than 0.5. I think that's too severe a discount for a company that has weathered the recession, increased its dividend, and should benefit from any cyclical upturn.

Given that I think the shares are cheap, I'm pleased to report the company spent £1.8m buying back 5% of its shares during 2013.

FINANCIALS AND VALUATION

The key here is the price-to-book ratio of just under 0.5 times, meaning we're theoretically buying £1 of J Smart's assets for less than 50p. Prior to the financial crisis, this ratio was above 0.8 times for several years, occasionally surpassing 1 times (so a slight premium to assets).

It's not unusual for commercial property companies to trade at a discount to the value of their assets, and the huge family holding and the vagaries of the construction division arguably deserve a larger discount than usual.

What's more, the Smart-surnamed directors undertake the property valuations – there's no reason to believe they weren't fair and above board, but a third-party assessment might be more reassuring. Ultimately though, they are owners in

the business, too, and they have adjusted the value of the properties downwards over recent years. Rental income has largely held up, giving some comfort.

For me, half price is too cheap. I think these shares might re-rate when the company is able to report stronger earnings and a better outlook. In the meantime, the 3% dividend yield pays you to wait.

Other metrics such as P/E are not part of my investment case here, as earnings have fluctuated wildly, and asset sales complicate things. Also, the company capitalises a lot of its own building work; this seems to me a good use of its workforce in a slow period, but may put off some.

Year ended 31 Mar	2010	2011	2012	2013
Sales (£m)	21.0	17.0	24.7	18.4
Pre-tax profits (£m)	4.0	0.7	0.1	0.8
Adjusted eps (pence)	10.0	11.1	(1.1)	0.8
Dividend per share (pence)	3.0	3.0	3.0	3.0

RISKS

The inevitable concern is you may someday suffer at the hands of J Smart's majority shareholders. Directors and related parties own nearly 55% of the company. I see no evidence of directors abusing this position so far – pay levels look modest, and there are no options or long-term incentive plans. But I'd be cautious how much of a portfolio goes into J Smart, just in case.

If the UK economy flounders, J Smart's construction activities could suffer further, and its property assets face more substantial write downs. Much of the economic revival to date has been in London and the South East, so it's important that Edinburgh – and Scotland more generally – starts to participate as well.

Talking of Scotland, with the vote on independence drawing ever closer, there is also a risk that any changes that ensue from a 'Yes' vote could have an effect on J Smart's prospects.

Construction sales totalling £11m came from just three customers in 2013, although this was better than 2012's, which saw only two major customers!

This is a small cap company, and the shares can be illiquid. Be careful what you pay, and consider building any position over time. The price may sometimes fall sharply just on lack of interest! This is a classic "bottom drawer" small cap stock, in my view.

WHEN I'D SELL

On pure valuation grounds, if the share price rose to give a price-to-book of 0.75 times, it might be time to consider moving on.

Less positively, you might reconsider your position if the company stops being run conservatively. For example, a big increase in debt levels, or a radical change of strategy could have you rethinking your investment.

Disclosure:

As of 29 November 2013, Owain owned shares in J. Smart.

Rexam: "Canning the World's Beverages"

BY CHARLY TRAVERS

REXAM

Market: Main (FTSE 100)
Ticker: REX
Headquarters: London
Website: www.rexam.com

FINANCIAL SNAPSHOT

Recent Price:......................499.6p
Market Cap:...................... £3.9bn
Net debt (as at 30 Jun 2013)....... £1.5bn
Data as at 29 Nov 2013

WHAT IT DOES

Rexam is a leading global consumer packaging group and a leading global beverage can maker.

WHY BUY

» Rexam is a global leader in the manufacturing of aluminium cans.
» The company can invest its profits back into the business and should earn low to mid-teens returns on capital, therefore creating value for shareholders.
» Shares look attractively priced for a business of this quality.

ABOUT THE COMPANY

Rexam (LSE: REX) manufactures approximately 61 billion beverage cans a year, making it one of the global leaders in the $22 billion global packaged beverage industry. Rexam's cans are used to package carbonated soft drinks, beer, iced tea, and energy drinks.

The company's customers include global beverage giants like **Anheuser-Busch InBev** (NYSE: BUD), **Coca-Cola** (NYSE: KO), and **Pepsi** (NYSE: PEP).

INVESTMENT THESIS

My investment thesis for Rexam rests upon the slow and steady increase in global aluminium can consumption each year. While consumption in mature Western economies has stabilised, considerable long-term growth potential remains in emerging markets, where packaged beverage consumption lags the US and Europe.

This is an important opportunity for Rexam, as just one-third of the company's sales come from emerging markets. The company is seeking to increase its exposure to the fastest growing economies in the world in places like India, South America, South East Asia, and sub-Saharan Africa. This is a sound strategy, in my opinion, as beverage can consumption tends to be closely correlated with a country's gross domestic product.

Rexam's management cites the Middle East and Africa as particularly attractive markets, since these regions have youthful populations that prefer canned beverages over other package types, such as plastic bottles.

The key trend for Rexam is emerging market economic growth leading to higher levels of per capita canned beverage consumption. Rising urbanisation and expanding middle classes should benefit Rexam.

FINANCIALS AND VALUATION

My investment thesis for Rexam rests upon the slow and steady increase in global aRexam's core aluminium cans business generated sales of £3.9 billion in 2012, gaining £100 million from the prior year. The balance of Rexam's sales derives from its healthcare business which makes items like plastic pill bottles.

Rexam is seeking to divest its healthcare segment, so that it can focus on its can business that now accounts for 90% of its revenue and pre-tax operating profit.

Year ended 31 Mar	2009	2010	2011	2012
Sales (£m)	4,533	4,619	4,232	4,312
Pre-tax profits (£m)	134	338	402	354
Adjusted eps (pence)	(4)	16	48	27
Dividend per share (pence)	9	13	16	17

Even though Rexam carries £1.6 billion debt against £156 million cash, I am comfortable with the company's financial position. Rexam should be able to readily

service its interest payments, and its debt/EBITDA ratio of 2.6 times is reasonable for a company with a strong market position and steady demand for its products.

Rexam shares currently trade at an enterprise value to EBITDA multiple of 8 to 9 times. I would not argue that Rexam shares are cheap at this level, but instead make the case that this is a fair price to pay for what I consider to be an excellent business.

RISKS

As a global company, Rexam is exposed to the same political, economic, and currency risks that face any multi-national corporation seeking growth in emerging markets. While these challenges can lead to volatile results from one year to the next, over time frames measured in decades, the growth potential seems too important to ignore.

Rexam's main manufacturing input is aluminium. Rexam's profit margins might suffer if aluminium costs rise, and the company is not able to pass along higher prices to its customers.

While aluminium cans are commonplace, strong competition comes from other packaged beverage options, including plastic and glass bottles. An industry shift to increased usage of these competing options could lead to a decline in Rexam's volumes.

WHEN I'D SELL

I am generally wary of companies in the process of digesting large acquisitions, and if Rexam were to merge with either of its major competitors, **Ball** (NYSE: BLL) or **Crown** (NYSE: CCK), I'd be a touch uneasy given the integration challenges that come with merging operations that are similar in size. I do concede that the potential efficiencies that could arise from larger scale could make such a combination appealing.

One of the attractive aspects of Rexam's business is that annual global aluminium can demand is on the rise in emerging markets. An investment in Rexam depends on the long-term prospects for aluminium can consumption in Africa, Latin America, and the Middle East. If Rexam is not able to grow its revenue in emerging markets, that would be a sign that the thesis is not correct and I would sell.

***Disclosure**:*

As of 29 November 2013, Charly did not own shares of Rexam.

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Blackhawk Network Holdings: "A gift idea for the investor in your family"

BY NATHAN PARMELEE

BLACKHAWK NETWORK

Market: Nasdaq, US
Ticker: HAWK
Headquarters: Pleasanton, California
Website: www.blackhawknetwork.com

FINANCIAL SNAPSHOT

Recent Price: $22.79
Market Cap: $1.2bn
Net cash (as at 7 Sep 2013) $103m
Data as at 29 Nov 2013

WHAT IT DOES

Blackhawk Network Holdings is a global leader in providing prepaid cards and related financial products and services.

WHY BUY

- Recent spin-off from the US-listed Safeway is now free to allocate capital and pursue an expansion strategy
- Long-term growth prospects remain abundant.
- Valuation looks compelling

ABOUT THE COMPANY

It wasn't that long ago that many retailers made their own gift certificates on paper. But in the last decade or so, gift cards have exploded in popularity.

At first, it was the retailers that led the charge, with gift cards specific to their own stores, but in time, all the large credit card networks entered the market, with their own prepaid cards that could be used any place their credit cards were accepted.

Now gift cards are ubiquitous and **Blackhawk Network** (NASDAQ: HAWK) helped lead the way in making gift cards popular and bringing innovation to the market.

Blackhawk was started in 2001 by US grocery giant **Safeway** (NYSE: SWY) as a way to expand the company's gift card offerings and grew from there.

Today, it offers gift cards from 500 retail partners, and then sells their cards in more than 100,000 retail locations worldwide. It also runs the giftcardmall.com website, and offers mobile top-ups and other services over its prepaid network.

If you shop at **Tesco** (LSE: TSCO) or **Morrisons** (LSE: MRW), you might already have some familiarity with Blackhawk's system, because it's the company behind their prepaid gift cards.

In April 2013, Safeway spun off Blackhawk as a separately listed company. Although Safeway remains a large customer, and still owns close to 75% of its shares, now Blackhawk is free to pursue an independent course without having to worry about the needs and capital requirements of Safeway.

INVESTMENT THESIS

Prepaid cards are a growth industry, and I'll get into the many ways Blackhawk can grow and expand its business in a moment. But a big part of the reason I like this company is because it is an established spinoff with room to grow. Once free to chart their own course, many spinoffs have a history of strong performance, and I believe Blackhawk fits that mould.

The most obvious way for Blackhawk to grow is to add additional retail gift card partners and stores to its network. This can be done in many ways, and one of the more intriguing is by adding local restaurant and merchant gift card offerings in each region. Consumers are likely to be interested in these offerings, and the businesses would benefit from increased distribution.

Blackhawk also has the opportunity to improve the productivity of its existing retail partners. Currently, 50% of Blackhawk's retail partners have what the company labels a basic offering. The other half is evenly split into two groups of enhanced offerings.

Enhanced stores are between 5 and 15 times more productive than the basic stores. Most of this is accomplished through expanded displays and improved in-store marketing, but stores with loyalty point rewards tend to be the best performers.

Blackhawk is working with existing customers to improve their offerings and it only needs to make improvements to 3% to 5% of its store base each year to enhance growth.

Simple growth of the industry and scaling the business as it grows are the final two ways Blackhawk can continue to grow at a healthy clip. Neither is fancy, but the continued growth of prepaid cards for gifts, corporate awards, and other purposes seems likely, and Blackhawk believes it can hold the line on its fixed costs.

FINANCIALS AND VALUATION

Over the past two years, Blackhawk has averaged 28% revenue growth. I believe it can continue to grow by at least 15% a year over the next three years. Assuming it does, so it's current enterprise value-to-EBITDA multiple of around 12 times could be a bargain, particularly in today's market where growth companies fetch a premium

Year ended 31 Dec	2010	2011	2012
Sales ($m)	578	752	959
Pre-tax profits ($m)	38	66	75
Adjusted eps ($)	0.37	0.70	0.93

Source: S&P Capital IQ

The table above highlights just how quickly Blackhawk has grown the past few years. In 2013, there could be a decline due to the one-time cost of becoming a public company, and the step change in operating costs needed to the meet the additional regulatory and disclosure requirements that are required as a result.

RISKS

I believe the greatest risk to Blackhawk is that gift card sales move online. Should this happen, it's possible that retailers might decide to manage their own gift card programs. To counter this, Blackhawk has one of the most popular online sites for gift cards, giftcardmall.com. Blackhawk has also formed partnerships with eBay's PayPal and mobile payments leader Monitise (LSE: MONI) to become their network for gift card sales.

While not a risk to the business, Blackhawk could also see volatility in its share price when Safeway decides how it might reduce its current controlling ownership stake. The company has hinted it might go ahead with a tax-free spinoff at a later date. However, this isn't certain, and it is possible that current Safeway holders could sell any Blackhawk shares they receive, as they might be focused on the potential of the grocery business and not the gift card and prepaid network.

Finally, as a US-listed business, any unfavourable movement in the pound's exchange rate against the dollar could have an adverse effect on any investment made. There can be additional dealing costs and administrative fees for US shares as well.

WHEN I'D SELL

If a technological development comes along that makes gift cards much less relevant or even obsolete, I would sell. Mobile wallets are a potential example of this, but we'll have to pay attention to who powers the gift cards in each mobile wallet. As we've seen with PayPal and Monitise, it's entirely possible that Blackhawk could be that partner, and evolve into the mobile world instead of being disrupted by it.

I would also consider selling if Blackhawk began to see declines in retail card partners or store partners offering its products, as this would be a sign that Blackhawk's network is weakening and no longer valued by retailers as a lucrative way to reach consumers.

Disclosure:

As of 29 November 2013, Nathan owned shares of Monitise and eBay. The Motley Fool owned shares of Monitise, eBay and Tesco. The Motley Fool has recommended shares of Morrisons and Tesco.

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ABOUT MOTLEY FOOL SHARES 2014

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Authorised by The McHattie Group, St Brandon's House, 29 Great George Street, Bristol, BS1 5QT.
Tel: 01179 200 070 | **Fax:** 01179 200 071 | **Email:** enquiries@mchattie.co.uk

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