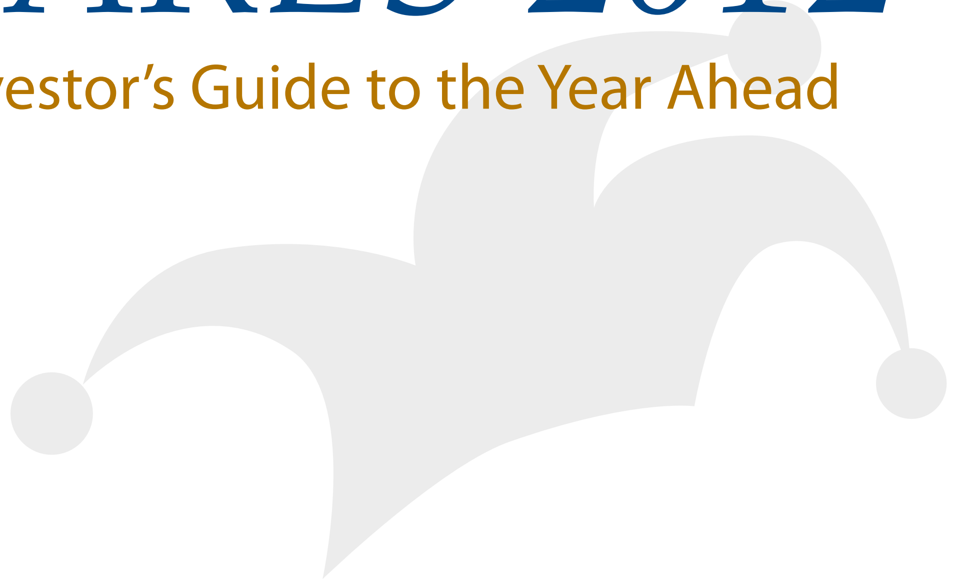
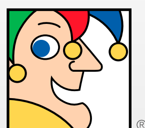
SHARES 2012

The Investor's Guide to the Year Ahead



From The Motley Fool's Top Analysts



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Introduction

BY STUART WATSON

Dear Foolish Investor,

Welcome to Shares 2012, where Motley Fool writers put forward a selection of shares that they believe will prosper over the coming year and beyond.

We've got 8 shares for you in this year's report. But before we look at those, here are the scorecards for the previous two Shares reports we've produced.

SHARES 2010

Company	Price as at 5 Nov 2009	Price as at 7 Feb 2012	Gain/loss
Charlemagne (LSE: CCAP)	17.75p	13.25p	-25.4%
GlaxoSmithKline (LSE: GSK)	1,220p	1,406p	15.2%
Goodwin (LSE: GDWN)	1,038p	1,275p	22.8%
Hansard (LSE: HSD)	175p	148p	-15.4%
Healthcare Locums (LSE: HLO)	266p	4.07p	-98.5%
National Grid (LSE: NG)	543.8p	644p	18.4%
Nautical Petroleum (LSE: NPE)	60.5p	324.5p	436.4%
PV Crystalox Solar (LSE: PVSC)	66.15p	5p	-92.4%
Tesco (LSE: TSCO)	418.7p	329.6p	-21.3%
Telecom Plus (LSE: TEP)	297.5p	643.5p	116.3%
Average			35.6%
FTSE 100	5,125	5,890	14.9%

SHARES 2011

Company	Price as at 12 Nov 2010	Price as at 7 Feb 2012	Gain/loss
GKN (LSE: GKN)	175.9p	221.5p	25.9%
Halfords (LSE: HFD)	410p	312.9p	-19.6%
McKay Securities (LSE: MCKS)	128p	113p	-10.2%
Mothercare (LSE: MTC)	524.5p	160.6p	-61.6%
NCC (LSE: NCC)	508p	807.5p	76.2%
Smith & Nephew (LSE: SN)	594p	589p	7.7%
Velosi (taken over)	102.5p	165p	61.0%
Average			11.3%
FTSE 100	5,797	5,890	1.6%

Note: In both tables, all prices are measured mid-price to mid-price and do not include any trading costs. Dividends are not included.

It's been a tough two years for the UK stock market but, as you can see, both sets of shares we picked are collectively beating the market at this stage. That said, we have definitely been disappointed by the proportion of gainers to losers, so an additional aim of our selections for Shares 2012 was to improve the consistency of our picks.

THIS YEAR'S LINE-UP

We have a mixture of sizes and sectors for Shares 2012. Top of the heap come the consumer brands company Reckitt Benckiser (LSE: RB) and defence firm BAE Systems (LSE: BA). While Reckitt has been a solid performer in recent years, BAE has been hurt by fears over defence spending cuts, particularly in its main U.S. market.

Representing the mid caps, we have the retailer Sports Direct (LSE: SPD) and engineering outfit Halma (LSE: HLMA). Sports Direct is a relative newcomer to the stock market, whereas Halma has been a listed company since 1972, and is one of those low-key companies that has rewarded its shareholders handsomely over the long term.

Finally, we have four small caps firms. Telecom firm Kcom (LSE: KCOM) and the agricultrial/financial conglomerate Camellia (LSE: CAM) both weigh in around the £300m mark. Software group Timeweave (LSE: TMW) and data centre specialist CSF (LSE: CSFG) are both tiddlers, however, valued at £100m or less. They are also both listed on the less-regulated AIM market.

We hope you enjoy this year's selection -- we'll be back with a new set of picks in twelve months' time for Shares 2013. Fool on!

Stuart Watson — Editor, Fool.co.uk.

Reckitt Benckiser: "Something for everyone"

BY JAMES EARLY AND NATHAN PARMALEE

RECKITT BENCKISER

Market: Main
Ticker: RB
Headquarters: Slough
www.reckittbenckiser.com

FINANCIAL SNAPSHOT

Recent Price:........................3,400p
Buy Guidance:....................3,600p
Market Cap:..........................£25bn
Net debt (31/12/11)............... £1.8bn
(Price data as of 07/02/12)

WHAT IT DOES

Reckitt Benckiser is a leading maker of household and health-care products. Its brands include Dettol, Cillit Bang, Vanish, Clearasil, Strepsils and Durex.

WHY BUY

- Product demand should be relatively insulated from economic swings
- Product demand should be relatively insulated from economic swings
- Undervalued on our discounted cash flow model
- Globally diversified with No. 1 products in 15 categories
- Strong commitment to raising the dividend

ABOUT THE COMPANY

Standing 40 feet tall and weighing nearly 6,500 kilograms, Tyrannosaurus Rex was the sort of fellow you'd want on your side in a pub fight. But the meat-eating, forest-dwelling T. Rex perished 65 million years ago alongside three-quarters of animal and plant life on Earth. Meanwhile, the humble, ubiquitous cockroach has been going strong for 350 million years.

Had you wagered on the future of each species, you'd have lost everything on T. Rex and made a fortune on the cockroach. And while no company can be expected to take kindly to a description of cockroach-like products, we mean it as a compliment to **Reckitt Benckiser** (LSE: RB), whose small, affordable, and ubiquitous products somehow find their way into nearly everyone's cupboards.

We feel Reckitt's famous brands -- *Dettol, Vanish, Finish, Cillit Bang,* along with many more -- aren't going away any time soon, and at its current price and yield, Reckitt appears fit to serve investors well in the years ahead.

Rechristened Reckitt Benckiser when Reckitt & Coleman merged with Benckiser in 1999, the company owns products that tend to own the shelves: of its 19 'powerbrands', 16 are gaining market share and 15 occupy the No. 1 or No. 2 spot: *Dettol* is the No. 1 disinfectant, *Durex* is the world's leading condom, *Mucinex* is No. 2 in cold care, while *Finish* leads in dishwasher tablets.

Meanwhile, Reckitt's small pharmaceutical business, representing 8% of turnover, revolves around *Suboxone* and *Subutex*, versions of an opiate replacement drug for weaning heroin addicts.

The company sports both a new CEO and CFO, though CEO Rakesh Kapoor has been with the company for more than 20 years. While some director sales have been posted recently, Reckitt is known for big dividend increases -- 9% in 2011, for example -- and yields a worthwhile 3.7% at current prices.

INVESTMENT THESIS

The thesis for Reckitt is largely one of no thesis -- in other words, we're convinced the company need only continue what it's been doing to reward investors. Indeed, we're hoping no major event has to happen, no catalyst need materialise, for Reckitt to be a successful investment.

We believe 'no-thesis' shares can be among the best investments for stability-seeking investors. But thesis-lovers need not flee the room, as Reckitt does stand to benefit from greater penetration into emerging markets, which currently comprise just 24% of turnover.

Reckitt has been growing amazingly quickly; it reported constant-currency growth of 13% in revenue and 11% in net income for 2011, which is phenomenal for a business as large as Reckitt -- but as rivals such as **Procter & Gamble** and **Unilever** have shown, the real growth is in emerging markets, meaning Reckitt should enjoy more runway ahead. Moreover, Reckitt's global platform allows it to purchase smaller companies and recognise operational synergies, as it's working to do with SSL's *Durex* condoms and *Dr. Scholl's* podiatry products.

FINANCIALS AND VALUATION

Reckitt's branding power comes to the fore in measures such as return on capital (ROC) and return on equity (ROE), which are essentially measures of how much income the company generates from the capital that's employed within the business. The high and sustained returns that Reckitt has earned (mid-20%s for ROC and mid-30%s for ROE) show us a brand-built moat that even a Tyrannosaurus would struggle to cross.

We've used a discounted cash flow model to value Reckitt, projecting annualised income growth several points less than City forecasts. A 10.5% equity discount rate fits a moderate-risk company such as Reckitt, and our model conservatively accounts for Reckitt's exemplary cash generation as well. All said, our valuation clocks in at 3,900p per share, which affords shareowners nearly 15% upside from current prices.

Year ended Dec	2008	2009	2010	2011
Sales (£m)	6,563	7,753	8,453	9,485
Pre-tax profits (£m)	1,474	1,895	2,136	2,376
Adjusted earnings per share (p)	155p	195p	214p	237p
Dividend per share (p)	80p	100p	115p	125p

**Source: RB 4th quarter 2011 presentation, RB 2010 annual report, Capital IQ*

RISKS

First, the bit you probably know: rivalry in consumer products is fierce, with commodity input costs and private-label competition constantly applying pressure. Product recalls and health-care legislation may create sporadic problems, too, as could the threat of poor merger integration, though as optimists, we give Reckitt the benefit of the doubt here.

Furthermore, roughly 5% of turnover is potentially affected by *Suboxone's* 2009 patent expiry in the US. Curiously, no generic competitor has emerged, but to scare off would-be entrants, Reckitt is replacing *Suboxone* with *Subutex*, a lower-margin sublingual film that's said to be a bit tastier. We'll pass on that, but note that Reckitt's European patent holds until 2016.

WHEN I'D SELL

Given Reckitt's strong, enduring history, we wouldn't sell this share lightly. A botched string of acquisitions or series of recalls may force us to question management's grasp on the business, which may in turn force a sale, while, as with any share, a wildly out-of-control valuation may prompt us to pull some (or all) off the table.

But as with biology, business evolution favours the tenacious and the ubiquitous. Reckitt began as a company in 1814, and while the group certainly won't outlast the cockroach, it seems poised to outlast many of its competitors. That hegemony should mean not only rich dividends, but a stability that ought to allow safety-seeking shareowners to invest a bit easier in the year ahead -- especially given the cushion Reckitt's current valuation affords.

As of 7 Feb 2012, neither James nor Nathan owned shares in Reckitt Benckiser. As of the same date, The Motley Fool owned shares in both Reckitt Benckiser and Unilever.

BAE Systems: "A global defence contractor at a bargain price."

BY MALCOLM WHEATLEY

BAE SYSTEMS

Market: Main
Ticker: BA
Headquarters: London
www.baesystems.com

FINANCIAL SNAPSHOT

Recent Price:........................ 318p
Buy Guidance:.....................320p
Market Cap:........................£10bn
Net debt (30/06/11)............... £1.1bn
(Price data as of 07/02/12)

WHAT IT DOES

BAE Systems is the world's second-largest defence company, supplying aircraft, warships, munitions, armoured vehicles, military electronics systems, and support services. Employing over 100,000 people, it has customers in over 100 countries.

WHY BUY

- Strong underlying business and global market leadership
- Significant aftermarket sales and services business
- Presently trading at a relatively low valuation on historic multiples
- Attractive yield, well-covered by earnings

ABOUT THE COMPANY

Formed in 1999 by the merger of Marconi Electronic Systems and British Aerospace, BAE Systems can trace its roots back to the Royal Gunpowder Factory in 1560.

Today, it is a diversified global engineering business, employing 100,000 people and supplying ships, aircraft, armoured vehicles, munitions and a wealth of electronic warfare systems. A growing amount of revenue -- presently 48% -- comes from service activities, and not manufacturing: engineering services, support services, and programme management services.

The company's activities fall into four broad categories, each of them accounting for between 20% and 30% of sales and profits.

Electronics, Intelligence & Support

In addition to digital engine and flight controls, this division specialises in electronic warfare systems, including electrooptical sensors and infrared technology.

Land & Armaments

This division manufactures armoured combat vehicles, naval guns, missile launchers, artillery systems, and munitions.

Programmes & Support

Primarily focused on UK-based air, naval, and cyberintelligence activities, this operation presently produces Typhoon and Hawk fighters, Queen Elizabeth class aircraft carriers, Astute class submarines, and Type 45 destroyers.

International

This subsidiary encompasses BAE's combined international operations in markets such as Australia, India, and Saudi Arabia, as well as its other foreign interests and joint ventures.

INVESTMENT THESIS

Trading at just 62% of their pre-recession high, the shares have been dogged by worries over defence cutbacks in BAE's major markets of the US and the UK.

As such, with its shares changing hands at 318p , BAE Systems looks attractive from both a yield and valuation perspective.

It is a combination which will have endeared the company to legendary fund manager Neil Woodford, who took advantage of the market's wobbles in the summer of 2011 to increase his stake in one of his funds from 78 million shares to 107 million shares, paying an estimated average price of 302p.

A member of the UK Mergent Dividend Achievers Index, the company has paid a steady or rising dividend payment for over ten years. As such BAE Systems should offer investors an attractive income while they wait for the share price to recover.

FINANCIALS AND VALUATION

According to an update published on 12 October 2011, sales and operating profits declined by 13% and 10% respectively against the same period last year. Underlying earnings per share exhibited more consistency, declining by just 4%.

Half-year cash inflow of £176 million compares with a full-year cash flow of £1.5 billion. Net debt grew from £242 million at 31 December 2010 to £1.1 billion, but it was down from £1.2 billion at the half-year point in 2010.

At 18p per share, the combined total of 2010's final dividend and 2011's interim dividend puts the shares on a trailing twelve-month yield of 5.7%. Consensus analyst estimates for 2012 predict a 7.6% dividend increase, placing the shares on a forecast yield of 6.1%.

Rated on a historic P/E of just over 10, with a forecast P/E of below 8, BAE Systems' shares are now trading at a meaningful discount to average historic multiples. A P/E of 15, for instance, would see the company's shares changing hands for 425p , a 34% premium to 7 February's price.

Year ended Dec	2007	2008	2009	2010
Sales (£bn)	15.7	18.5	22.0	22.3
Pre-tax profits (£bn)	1.2	2.5	0.3	1.5
Adjusted earnings per share (p)	30.1p	37.1p	40.1p	39.8p
Dividend per share (p)	12.8p	14.5p	16.0p	17.5p

RISKS

BAE Systems sells to a relative handful of key customers. In 2010, for instance, just five markets -- Australia, India, Saudi Arabia, the UK and the US -- generated 92% of sales.

What's more, customers in several of those markets are cutting defence expenditure. The UK government's recent Strategic Defence and Security Review, for example, saw the Nimrod MRA4 programme terminated, the Harrier aircraft taken out of service, and delays to the Queen Elizabeth aircraft carrier programme.

Quite apart from the 'top line' risk to revenues from cutbacks, there are execution risks associated with the consequent rationalisation and efficiency programme that the company has put in place. If the company fails to achieve its expected savings, profits may be squeezed even further.

Finally, investors must bear in mind the company's pension deficit, which is the subject of a deficit reduction plan running until 2026, and the fact that a significant proportion of sales -- over half -- is generated in US dollars, leaving the company open to exchange rate fluctuations.

WHEN I'D SELL

Clearly, a material long-term worsening of the company's sales prospects in its key markets of the US and UK would be counter to the investment thesis, and could prompt a sale.

Equally, the company offers a yield that is much higher than the FTSE All-Share average, while trading on a below-average P/E. A material reversal of these figures could also prompt a sale, as the value would have been outed, and the income case weakened.

As of 7 Feb 2012, Malcolm held shares in BAE Systems.

Sports Direct International: "These shares play to win"

BY CHARLY TRAVERS AND NATE WEISSHAAR

SPORTS DIRECT INTERNATIONAL

Market: Main
Ticker: SPD
Headquarters: Mansfield
www.sports-direct-international.com

FINANCIAL SNAPSHOT

Recent Price:........................ 257p
Buy Guidance:.....................265p
Market Cap:...................... £1.5bn
Net debt (23/10/11)............... £114m
(Price data as of 07/02/12)

WHAT IT DOES

Sports Direct is the largest retailer of sports equipment and clothing in the UK.

WHY BUY

» Shares are trading at less than 11 times average free cash flow of the past two years, which makes them quite attractive in our view.
» Excellent long-term growth potential, with ample opportunities for expansion across Europe.
» Strong competitive position compared to other UK sports retailers.
» Long-tenured management who have proven to be top-notch business leaders.

ABOUT THE COMPANY

Founded in 1982 by entrepreneur Mike Ashley -- who in recent years has garnered significant notoriety as the owner of Newcastle United -- Sports Direct has grown to become one of the UK's retailing champions. Much of the firm's success over its three-decade history comes from a shrewd management team that makes opportunistic acquisitions of competing retailers and sports brands that are distressed and put on the block at fire-sale prices.

The company operates several different store formats, including flagship Sportsdirect.com, Lillywhites, and Field & Trek. These stores sell leading global sports brands, including adidas, Nike, and Puma, as well as company-owned brands like Dunlop, Everlast, and Slazenger. This combination of selling the most popular brands at great prices alongside its proprietary brands, where it tends to earn higher profit margins, has been immensely successful, as demonstrated by the impressive returns on capital it generates.

INVESTMENT THESIS

Sports Direct is not content to be the top sports retailer in the UK. The company is on a mission to expand across Europe, and within the next five years it plans to have a presence in all 17 countries that have adopted the euro. Key markets earmarked for future growth include Belgium, Ireland, and France.

We think Sports Direct is being smart with its international expansion strategy. It enters new markets at a slow and measured pace, and appears to be willing to enter into joint venture partnerships with retailers that already have an established presence in the market, as it did with Ireland with Heatons.

The Sports Direct playbook appears both simple and effective. The group seems to have ample opportunity to reinvest its profits back into its business, where it generates very attractive returns on invested capital. Businesses that can pull this feat off are 'compounding machines' that we believe can create tremendous value for shareholders over long periods of time.

FINANCIALS AND VALUATION

Year ended April	2008	2009	2010	2011
Sales (£m)	1,260	1,367	1,452	1,599
Pre-tax profits (£m)	119	11	120	119
Adjusted earnings per share (p)	8.6p	7.9p	12.4p	16.8p
Dividend per share (p)	4.5p	1.2p	--	--

As the Sports Direct empire keeps growing, its sales march ever higher, setting an all-time record of £1.6 billion during its last financial year. Profit growth has been less impressive, though that's primarily due to year-to-year variability in exchange rates and "one-time" items like asset write downs. The measure we're most

interested in, free cash flow, has increased four years running, with Sports Direct delivering £164m in free cash in its latest financial year.

In recent years, Sports Direct has elected to retain its profits in the business, instead of paying them out to shareholders. While dividend cuts tend to anger investors, we reckon Sports Direct has made the right decision on this, given its ability to deploy its profits into growing the business.

With the shares trading at 9 times free cash flow, the market appears to be pricing in a difficult year or two for Sports Direct, and seems to be predicting lower profits than what the company has produced over the past two years. The market may be right on that score, but we find the current price to be an attractive entry point into a company that we believe has bright long-term growth prospects.

RISKS

Retailers fare poorly in difficult economic conditions, as consumers become more cautious with their spending. Making matters worse is that stores have fixed costs that can't be cut, so as sales drop off profits tend to fall even faster. Although Sports Direct is not immune to the slow economic growth plaguing the UK and Europe, we think it is able to act from a position of strength and aggressively improve its competitive position, while its weaker peers struggle for survival.

The popularity of purchasing goods through the internet is exploding due to the low prices, broad product selection, and convenience of sites like Amazon.com. This paradigm shift of consumer spending from bricks and mortar stores to ecommerce is one of the biggest challenges affecting all retailers. Sports Direct is responding to this competitive threat with its own online presence, which generated 9.5% of its overall sales in the half year to 23 October 2011, but we have to be aware of this formidable competitor and any others that may emerge in the future.

WHEN I'D SELL

Fickle consumers and cutthroat competitors make life difficult for a retailer and could cause Sports Direct's financial performance to take a turn for the worse. Fools are long-term minded business owners, willing to ride out a bumpy quarter or two, but we would need to be convinced any problems are temporary and not signs of a permanently broken business. If Sports Direct runs into trouble and there are no signs of future improvement, we would no longer be interested in owning shares and would recommend selling.

We believe that Sports Direct is an excellent business with attractive long-term growth prospects. But we don't want to own overvalued shares. If, for example, the shares started trading close to 20 times free cash flow that would indicate much of Sports Direct's future growth has already been priced into the stock. If that happens, we'd happily sell and book any gain.

As at 7 Feb 12, neither Charly nor Nate owned shares in Sports Direct.

Halma:
"A safety-focused investment for your portfolio"

BY OWAIN BENNALLACK

HALMA

Market: Main
Ticker: HLMA
Headquarters: Amersham
www.halma.com

FINANCIAL SNAPSHOT

Recent Price:........................ 371p
Buy Guidance:.....................**380p**
Market Cap:....................... £1.4bn
Net debt (01/10/11).................£56m
(Price data as of 07/02/12)

WHAT IT DOES

Halma is a group of globally distributed companies that manufacture products for hazard detection and life protection.

WHY BUY

- Entrepreneurial corporate structure
- Defensive market niche
- Increasingly global manufacturing and customer base
- Long history of rising dividends

ABOUT THE COMPANY

If I said **Halma** (LSE: HLMA) was an engineering company, then added it would make a great addition to your portfolio for the stable growth it should deliver, you'd probably look at me sideways.

Isn't engineering notoriously cyclical? Wouldn't Halma's share price oscillate like an overweight banker bungee jumping? And what about the dividend? Lurching from feast to famine might be a fun game for hedge funds, but most of us prefer a gradually rising payout.

Well, a steadily rising dividend is exactly what Halma's shareholders have come to expect. In fact, Halma's website boasts the firm is one of only three companies on the London market to have lifted its payout by at least 5% a year for more than 30 years.

You see, Halma is no typical engineer. It's a multinational conglomerate consisting of several dozen subsidiary companies, each with their own executive management team. What's more, these companies operate in three niches -- Infrastructure Sensors, Health and Analysis, and Industrial Safety -- that tend to have more defensive qualities than typical manufacturing. And Halma maintains its edge through substantial research and development, not by being cheapest.

In my opinion, the decentralised business structure of Halma is a big reason why it's long managed to successfully grow through acquisition as well as organic growth. I suspect it also helps keep R&D well targeted, shoring up Halma's strong margins.

INVESTMENT THESIS

What's particularly interesting about investing in Halma today, though, is that it's increasingly looking to the faster-developing regions of the world.

With its long history of arms-length management of companies based in many different countries, I reckon that Halma looks especially capable of establishing 'hub' businesses in China, India, and South America, with less execution risk than many other companies.

In 2011, Halma added three new regional offices in China to bring the total to five, helping Chinese revenue grow by 28% year-on-year, and to quadruple since 2006. The headcount in India doubled.

I think this rapid rollout across the most dynamic industrial regions of the world -- where sales are expanding from a relatively low base -- makes Halma a compelling way to play the emerging markets. And unlike some alternatives, its great dividend record points to a boardroom that should ensure shareholders are the chief beneficiaries.

FINANCIALS AND VALUATION

Crucially, backing Halma's growth potential doesn't come at the cost of investing in a precariously positioned firm. On the contrary its recent performance shows how well it shrugged off the global slowdown:

Year ended March	2008	2009	2010	2011
Sales (£m)	395	456	459	518
Pre-tax profits (£m)	68.0	72.8	81.4	98.3
Adjusted earnings per share (p)	14.0p	16.1p	19.2p	20.3p
Dividend per share (p)	7.55p	7.93p	8.50p	9.10p

Halma's balance sheet appears strong, too. While net debt has been increasing, it's still only £56m, which seems trivial given the group's size. The forecast 2.7% dividend yield is 2.5x covered by analysts' forecast earnings.

Unfortunately for new investors, this resilience has already been spotted by the market. Halma shares are priced on a P/E of 18 on a historical basis -- expensive compared to the market -- and while the P/E should fall to around 15 if Halma hits analysts estimates of around 24.5p per share for the year to March 2012, that rating is not a bargain, either.

But as I've argued, Halma is no ordinary engineer. I believe its performance through the global slowdown deserves a premium, while equally its past and forecast growth shows this is no dull defensive.

While I think buying Halma is a long-term opportunity worth seizing at up to 380p per share, I'd really prefer to be recommending them much cheaper. The dividend yield, for instance, currently equates to slightly less than 3%, whereas Halma has traditionally yielded a lot more than that. The share price is already well below last year's 429p peak, but cautious investors might want to take a small initial position and save some ammunition in case of further falls.

RISKS

While Halma operates in many territories and its products are pretty niche, it is still geared to overall global economic activity. Signs the Chinese economy may be contracting could be worrying, since Halma plans for China to comprise 10% of group revenue by 2015.

As I mentioned, Halma regularly makes targeted acquisitions. Its record is good, but all acquisitions come with the danger of over-paying, unexpected liabilities etc, so Halma's strategy of achieving roughly half its growth through acquisition is riskier than pure organic expansion.

According to Halma's 2011 Annual Report, the deficit on the group's defined benefit pension plans was £36m. As a result, Halma makes extra payments of £6.4m a year into them -- a cash drain that could otherwise go on dividends or reinvestment. Even higher payments could be required if stock markets fall further.

WHEN I'D SELL

If my investment thesis is correct, then Halma is one to tuck away for the long term. Developments that might make you reconsider your investment should concern operations and management rather than valuation, as well as any change to Halma's shareholder-friendly culture. And any sign that the 5% or more annual increase in the dividend is under threat would be ominous.

If Halma went for an uncharacteristically large takeover or merger, I'd be concerned management was tampering with a winning formula and consider selling.

There's always a possibility that something mission-critical Halma manufactures could fail in some spectacular way one day. In such unfortunate circumstances, you'd do best estimating the long-term impact to Halma's reputation, taking note of how it acted to regain customer trust.

As of 7 Feb 2012, Owain Bennallack held shares in Halma.

KCOM Group: "A telecoms opportunity for the next decade"

BY ALAN OSCROFT

KCOM GROUP

Market: Main
Ticker: KCOM
Headquarters: Kingston-upon-Hull
www.kcom.com

FINANCIAL SNAPSHOT

Recent Price:........................ 73p
Buy Guidance:...................... 85p
Market Cap:...................... £377m
Net debt (30/09/11)................£75m
(Price data as of 07/02/12)

WHAT IT DOES

KCOM provides a range of communications and IT services to businesses, and still serves local residents with telephony services.

WHY BUY

» Focus on long-term organic growth
» Strong cash flow and modest debt
» Good long-term dividend prospect
» Short-term modest P/E and high dividend yield

ABOUT THE COMPANY

KCOM started life in 1902 as a telecoms provider run by Hull Corporation, and opened its first exchange two years later. When the rest of the UK's municipal telephone services were amalgamated to form British Telecom, Hull was the only town to remain independent. Hull is, to this day, the only town in the country not to be served by BT, and has retained its original cream-coloured telephone boxes.

In 1999, the company listed on the London Stock Exchange as Kingston Communications. It has since expanded its range of domestic services in its local area, and now offers communications and IT services to a wide variety of organisations nationally.

Today, rebranded as KCOM Group, the company works in partnership with BT's wholesale division, and with others including Cisco, Phoenix IT, Microsoft and O2, to offer a range of services.

INVESTMENT THESIS

There is a growing demand for telecommunications, particularly broadband, and increasing requirements from all sorts of organisations for all-in-one managed communications and IT services. Many firms are turning towards smaller providers for the greater flexibility, and arguably better customer-focused response, that they can offer over the big guns like BT.

On that score, KCOM has attracted some impressive customers, and counts Morrisons, Lloyds TSB, SpecSavers, Admiral Insurance, British Airways, the City of London, North Wales Police, and several NHS trusts and county councils on its list.

Also attractive is KCOM's prudent management. KCOM did not take on huge debt in order to finance rapid expansion, and has not gone on any high-risk acquisition sprees. Instead, it has grown at a sustainable pace, employing strong partnerships, which put it in a good defensive position when the recent economic crisis hit.

Revenues and underlying profits did fall during the downturn, and the dividend was cut in 2009. But the payout had rebounded strongly by March 2011, and analysts are expecting increased dividends for the next two years. And with a strongly cash-generative business, debt levels have remained modest, falling to just £75m at the September 30 half way stage.

You could have picked up the shares for as little as 10p at the end of 2008, since when they've advanced seven-fold.

FINANCIALS AND VALUATION

The KCOM financial picture for the last four years is as follows:

Year ended March	2008	2009	2010	2011
Sales (£m)	517	472	413	395
Pre-tax profits (£m)	4.4	(111.0)	19.2	32.9
Adjusted earnings per share (p)	3.6p	(20.7p)	3.4p	4.3p
Dividend per share (p)	2.82p	1.5p	1.75p	3.6p

Source: Annual reports, 2008-2011

The pre-tax loss for 2009 looks poor, but that includes the restructuring costs of refocusing the company into two strategic divisions, one covering traditional local domestic subscribers, the other taking care of the national business-to-business services.

Stripping out those exceptional items, KCOM rates its underlying pre-tax profit for 2009 at £17.9m, and puts 2010's figure at £29.4m. One result of the restructuring has been an increase in profitability, with higher value services producing better profits from lower turnover.

Within KCOM's latest interim results, the dividend was on course to grow by the group's 10% full-year target, with a 20% boost to the first-half payout coming from a rise in profits of 23%.

City analysts are currently forecasting earnings of 7p per share for March 2012 and a full-year dividend of 4.1p. That's a prospective yield of 5.6%, which looks very appealing for a technology-based company with decent growth prospects. The prospective year-end P/E ratio stands at 10, which looks undemanding.

RISKS

One of the main risks for smaller telecoms companies is that they will eventually be beaten by the big fish in the pond, which is what happened to several in the early 2000s. But since then, smaller companies have established more of a foothold, and the growth of a healthy wholesale market for telecoms services has strengthened their prospects. And KCOM is one of the larger and better established operators.

The dividend may fluctuate, which is not ideal for income investors. Despite that 10% growth target, forecasts suggest a dividend cover of only about 1.7 times -- so if future earnings do fluctuate, there might not be the cash to keep the dividends growing.

Another risk is that the shares might not be seen as cheap by the market, as they gained 20% last year. But that's very short term, and does not echo what I see as a still undervalued share.

WHEN I'D SELL

From a dividend perspective, I might consider selling when I see the price rise enough to bring the yield down to around 4 to 4.5%, which at current estimates suggests around 95p if the dividend isn't increased.

But that ignores the growth potential, and what I'd really be wanting from the company is steadily growing profits with good margins. So if I started to see profits growing more slowly than revenues, or saw the market for smaller telecoms companies starting to face pressure, I'd think of selling.

As at 7 Feb 2012, Alan did not own shares in KCOM.

Camellia: "Worldwide essentials"

BY DAVID HOLDING

CAMELLIA

Market: Main
Ticker: CAM
Headquarters: Linton
www.camellia.plc.uk

FINANCIAL SNAPSHOT

Recent Price:..........................£99
Buy Guidance: £110
Market Cap:...................... £269m
Net cash (30/06/11)...................£64m
(Price data as of 07/02/12)

WHAT IT DOES

Camellia is a UK-based international group employing over 75,000 people worldwide, with interests in agriculture and horticulture, private banking and financial services, food storage and distribution, engineering and insurance.

WHY BUY

- Strong balance sheet
- Defensive
- Diverse
- Cash-rich
- Conservative
- Steady growth

ABOUT THE COMPANY

Camellia's origins go back to the 19th century with The Sephinjuri Bheel Tea Company, which started business in 1889 with one tea garden in north east India.

Gradually, the company developed into a vehicle for investment, building a stake in a major tea agent company, and its name was changed to Camellia Investments in 1964 (Camellia sinensis being the botanical name for the tea plant). Since the 1980s, Camellia has undertaken a number of mergers.

Today, Camellia has diverse interests all around the world. Examples include: Tea production in India, Bangladesh, Kenya and Malawi; pistachio nuts and citrus fruits in California; avocados in Kenya; rubber in Bangladesh; farming in Brazil; food storage and distribution in Holland; wine grapes in South Africa; property and insurance in Bermuda, and both engineering and private banking in the UK. Many companies in the group are over 100 years old.

Camilla generates around 28% of its revenues in India, 25% in the UK, and 11% in each of Kenya and continental Europe.

Over half the company is owned by Camellia Holding AG, which in turn is owned by The Camellia Private Trust Company Limited; a charitable foundation incorporated in Bermuda, which supports educational and humanitarian causes. The foundation takes no part in the day-to-day management of the business.

INVESTMENT THESIS

"...a decade of exceptional political change and financial irresponsibility.... never before have so many young people with little experience of business, and even less of life, been paid unprecedently large sums of money... It is against this background that I would like to inform our shareholders of Camellia's philosophy ... our priority is not towards acquisitions but to the continuous improvement of the group's existing assets. Above all we will never overreach ourselves so that our base becomes vulnerable to the changing circumstances of the banks."

These words were written over 20 years ago by Gordon Fox, the architect of the present structure of the Camellia group. How little things change.

By their very nature, the businesses in Camellia's portfolio require management to take a long-term view. Camellia's fundamental ethos is to treat its business assets as "living entities" from which, if properly managed, the company's shareholders should make an attractive investment return.

It is on this 'philosophical' basis that I like Camellia as a long-term investment. I believe the company demonstrates sound fundamental value, and provides diverse essential goods and services from various locations around the planet. What's more, I reckon it has a rock-solid balance sheet and an enviable record of steady and secure profitable growth.

FINANCIALS AND VALUATION

Year ended Dec	2007	2008	2009	2010
Sales (£m)	162	191	230	251
Pre-tax profits (£m)	31	24	34	73
Adjusted earnings per share (p)	911p	397p	572p	1,511p
Dividend per share (p)	92p	92p	94p	110p

At a share price of £99, Camellia has a market capitalisation of £269m. In return, investors are buying into a company with £353m of net tangible assets. With the latest reported results, Camellia also had close to £64m in net cash, and net current assets of almost £115m.

Camellia hasn't been loss-making at an operational level at any time. In fact, it has steadily grown both turnover and profits, with only the occasional blip.

So its current valuation makes little sense to me. Camellia's UK private bank (Duncan Lawrie) is very conservatively run, with limits on its loans that are not allowed to exceed the bank's share capital and reserves.

There are no broker forecasts for Camellia that I'm aware of. Last year's earnings figures were boosted by an unrealised gain on the value of agricultural assets to the tune of £11m. Stripping this out of the earnings per share figures puts last year's underlying P/E at about 8.

The historic earnings figures are erratic due to exchange rates and asset valuations, disposals and acquisitions.

Unfortunately, Camellia's yield isn't as generous as it might be. In the last full year, dividends totalled 110p, making the yield around 1.1% -- which is covered many times over by cash-flow and earnings.

RISKS

The main financial risk I see with holding shares in Camellia is one of the shares languishing due to the relative paucity of income and the ownership structure. In other words; a risk of opportunity cost.

Operationally, the group will face risks in different areas from time to time -- as was the case in the Darjeeling and the Dooars region of West Bengal last year. Other countries in which Camellia has operations, such as Bangladesh, Kenya and Malawi, tend to be politically less stable, while in Kenya, Malawi and South Africa there are long-term issues concerning land ownership.

Also, any farming and horticultural operation is at risk of unfavourable climatic conditions, pestilence and the like.

Currency risks are managed through "natural" hedging. The company regularly reviews when cash should be exchanged into sterling or another currency.

WHEN I'D SELL

I believe Camellia's shares could be worth around £160, and I would sell if the shares reached that point in the near future (for some reason like a bid approach, for example).

Otherwise, I would consider Camellia shares are "to have and to hold", as they (hopefully) gradually go higher along with net assets and profitability.

No company is risk free, but Camellia's ethos, balance sheet strength and diverse interests in essentials make it safer than most other companies in my opinion.

As at 7 Feb 2012, David did not own shares in Camellia.

Timeweave: "An each-way bet on a thoroughbred asset"

BY MAYNARD PATON

TIMEWEAVE

Market: Main
Ticker: TMW
Headquarters: Reigate
www.timeweave.com

FINANCIAL SNAPSHOT

Recent Price: 23p
Buy Guidance: 28p
Market Cap: £52m
Net cash (30/06/11) £24m
(Price data as of 07/02/12)

WHAT IT DOES

Timeweave owns 50% of TurfTV, a specialist horse-racing broadcaster for bookmakers, as well as approximately £24m of surplus cash.

WHY BUY

- Straightforward small-cap 'special situation'
- TurfTV joint venture enjoys multi-year contracts and attractive accounts
- Surplus cash position represents 46% of market cap
- Estimated dividend yield of 8% or more

ABOUT THE COMPANY

People often say buying shares is just like betting on the horses -- they're both a pure gamble. Well, I'm convinced examining annual reports for good, cheap businesses -- and racecards for horses likely to stay the course -- can give us more chance of picking a winner!

Having studied the form, I'm now declaring **Timeweave** (LSE: TMW) as a cracking each-way bet for bumper returns during 2012 and beyond.

This obscure, strangely named small-cap co-owns TurfTV, a specialist horse-racing broadcaster that supplies the country's bookmakers with live race action. While Timeweave's current starting price suggests an unfancied runner, the firm's TurfTV stake looks to me like a champion asset -- and has helped attract two bid approaches during the last four years. Timeweave's strong cash position should also put the odds in our favour.

INVESTMENT THESIS

I must admit Timeweave almost became a non-starter during the banking crash. The firm, which originally sold software for the leisure industry, fell badly after incurring hefty losses and scrapping its dividend. To keep itself from the knacker's yard, Timeweave had to sell its software subsidiary and launch a rights issue.

Year ended	Nov 2007	Nov 2008	Nov 2009	Dec 2010*
Sales (£m)	30.1	35.9	26.2	29.9
Pre-tax profits (£m)	(5.1)	(2.2)	6.9	7.7p
Adjusted earnings per share (p)	(2.6p)	0.8p	2.4p	2.8p
Dividend per share (p)	--	--	1.7p	2.6p

Source: 2010 annual report. *13-month period

These days, Timeweave's sole operating asset is a 50% stake in TurfTV -- a joint venture that boasts the exclusive broadcast rights to horse racing at 31 racecourses, including Aintree, Ascot, Cheltenham, Epsom, Goodwood and Newmarket (these racecourses, through a consortium, own the other 50% of TurfTV). Another three courses will join TurfTV's service next year.

TurfTV launched during 2007 and, according to the channel's website, individual betting shops must pay £7,030 a year to receive the live racing. Ensuring some stability to revenue, TurfTV has arranged five-year supply contracts with leading bookies **William Hill** (LSE: WMH), **Ladbrokes** (LSE: LAD), **Coral** and **Betfred**.

FINANCIALS AND VALUATION

Timeweave boasts a stallion-like balance sheet. Bolstered by the aforementioned disposal and rights issue, the latest cash position stood at £24m, excluding £3m held

within TurfTV and £2m held in escrow. You'll be pleased to know there are no borrowings or pension liabilities to unseat us, either.

TurfTV's operating pedigree is emphasised by the venture's thoroughbred margins. The broadcaster has only one real competitor -- Satellite Information Services -- and the duopoly allows a generous 25% of TurfTV's sales to convert into profit.

August's interim results showed TurfTV's like-for-like profits up 4% and management commented about the venture "trading well". I calculate Timeweave's share of TurfTV's earnings currently runs at 2.4p per share, which puts the 23p shares on a P/E of less than 10. Strip out Timeweave's £24m cash, however, and the TurfTV stake looks to be valued at a lowly 6 times profits.

During 2010, Timeweave announced it would return "a significant proportion of net profits to shareholders each year". August's interim dividend was 1p per share and I think it's odds-on the full-year payout will be at least 2p per share to support a possible income of 8%-plus.

RISKS

Of course Timeweave may end up as an also ran. My nap of *Shares 2012* is dependent entirely on the horseracing and bookmaking industries, and could be left at the starting gates if the ongoing friction between the two industries continues.

In particular, the British Horseracing Authority has, since 2007/8, seen the annual levy it receives from the bookies fall from £115m to £72m. If the Authority's income declines further, I worry race fixtures could be dropped and the value of TurfTV's rights might then drift lower.

Indeed, the betting industry argues the recession and alternative forms of gambling may justify even lower levy payments. You see, the bookies believe they "now pay as much for their pictures as they do in levy and this sharp escalation in cost has made racing by far the most expensive product in the betting shop."

In fact, the bookies took TurfTV to court a few years ago, alleging the broadcaster had broken competition laws and the 31 racecourses had essentially sold their rights as a cartel. Although the bookies were pulled up by the judge and now pay for the channel, this fractious customer relationship could one day break down.

Timeweave's subdued potential is another possible handicap. With all the major bookies now active customers, TurfTV's seems trapped on the rails when it comes to further expansion.

And suffice to say, there's always the chance Timeweave blows its £24m cash pile on a long-shot acquisition. Indeed, following a small purchase, the group has already diversified and a subsidiary now offers hedging agreements based on the outcome of major sporting events.

WHEN I'D SELL

True, a lack of real growth opportunities and those unhappy bookies could make this a 'mare of an investment, and certainly Timeweave placing an extravagant wager with its cash hoard would see me bolt from this share.

However, multi-year contracts, super margins and respectable trading -- plus some previous bid interest -- does suggest TurfTV could be a genuine Red Rum of a business, while that 8% potential income may be an attractive hedge against further turmoil in the wider economy.

As we line up for 2012, I'm tipping this lowly rated small-cap as my favourite dark horse for coming home a surprise winner -- and I suggest you mark your card by placing a small sidebet.

As at 7 Feb 2012, Maynard did not own shares in Timeweave.

CSF Group: "Growth at an attractive valuation"

BY G A CHESTER

CSF GROUP

Market: AIM
Ticker: CSFG
Headquarters: Malaysia
www.csf-group.com

FINANCIAL SNAPSHOT

Recent Price:........................ 60p
Buy Guidance: **75p**
Market Cap:..........................£95m
Net cash (30/09/11).................£12m
(Price data as of 07/02/12)

WHAT IT DOES

CSF Group is a provider of data centre facilities and services in South East Asia.

WHY BUY

- High growth sector and region
- Early-mover advantage
- Increasing recurring revenues
- Attractive valuation relative to peers

ABOUT THE COMPANY

Since its founding in 1991, CSF Group has built and fitted-out over 200 data centres in Malaysia, for clients including government departments, telecommunications companies, and financial institutions.

In 2003, the group completed the development and build of the first of its own commercial data centres, CX1, in Cyberjaya (Malaysia's 'Silicon Valley'). CSF rents space in these centres to a diverse client base that includes domestic blue chips and large multinational corporations.

In March 2010, CSF was floated on AIM, raising £28m at 55p per share. The bulk of the proceeds was earmarked to finance the development and initial construction stage of CX5, the group's largest and highest-spec project to date, which should double its existing data centre capacity.

INVESTMENT THESIS

Demand for data centre space in Malaysia and South East Asia is being driven by rapid growth in domestic internet usage, the rising technological sophistication of local companies, and an increase in the number of international businesses seeking a data centre hub in the region, particularly as an access point into China.

I'm convinced CSF has an early-mover advantage, a strong business model, and a clear strategy for achieving its medium to long-term objective of managing an interconnected and integrated hub of data centres strategically located across the region.

I understand the group is already the market leader in Malaysia, with 35% of outsourced space, and has further projects in the pipeline that should grow its market share. CSF is also expanding into neighbouring territories in a measured way, with joint-venture projects in Indonesia and Vietnam, and potential projects in Singapore and Thailand.

Building data centres is a capital-intensive business, but CSF's equity fundraising, a sale and leaseback strategy on its buildings, and partnership projects in new territories, should enable it to expand its estate quickly, without assuming undue financing risks.

The group enjoys low customer churn, with tenant renewal rates of 90%, and maintenance contracts with both tenants and external clients providing a growing source of recurring revenues. Strong cash generation should increasingly underpin the business, and the company is already paying a reasonable dividend.

At the present time, news is awaited in a number of areas. Most notably, negotiations with a 'high calibre anchor tenant' for CX5's flagship Block A are taking longer than initially anticipated. However, once there is concrete positive news, CSF's shares could be expected to start re-rating from what currently looks a very modest valuation.

FINANCIALS AND VALUATION

The table below shows CSF's figures in its first year as a listed company (2011), and pro-forma figures for the three years prior to flotation.

Year ended March	2008	2009	2010	2011
Sales (£m)	8.8	10.7	14.3	23.3
Pre-tax profits (£m)	1.8	0.1	9.0	10.2
Adjusted earnings per share (p)	0.9p	(0.3p)	0.2p	2.8p
Dividend per share (p)	--	--	--	1.92p

Source: Hemscott. Exchanges rates used: MYR to GBP-- 2008: 6.4, 2009: 5.2, 2010: 5.0, 2011: 4.9

CSF has already released its first-half results for the year to March 2012, posting revenue of £18.4m and earnings per share of 3.12p. The board reported strong trading since the half-year end, and said it anticipates profit for the full year to be in line with market expectations.

Those expectations, based on the consensus forecasts of the two brokers that cover CSF, are as follows:

Year ended March	2012	2013
Sales (£m)	38.6	44.2
Pre-tax profits (£m)	13.0	15.4
Adjusted earnings per share (p)	6.5	7.6
Dividend per share (p)	2.2	2.5

At 60p, CSF's shares are trading on 9 times earnings expectations for the current year, falling to 8 times next year as a result of forecast earnings growth of 19%.

To put that rating into context, CSF's peer, **TeleCity Group** (LSE: TCY), has been trading on over 20 times forecast earnings for both the current year and next.

While CSF merits a discount to TeleCity -- TeleCity is a larger company, operating in the UK and Europe -- I think the discount is too big, in view of what CSF has already achieved in the fast-growth South East Asia region.

Moreover, TeleCity's rating is one that CSF can aspire towards, the more CSF proves its business to the market's satisfaction, and increases its size to a level that will attract wider interest from institutional investors.

RISKS

In addition to the geo-political risks faced by any business operating in a developing region, and the reputational risk of a catastrophic systems failure faced by all data centre operators, I see three main risks for investors in CSF.

First, while barriers to entry into the commercial data centre business are relatively high, a new entrant into CSF's markets with significantly greater financial firepower would pose a serious threat.

Second, unforeseen delays and expenses with a project build-out, or in sourcing new tenants, could set back earnings growth in the short term, and likely keep CSF's share price subdued in 2012.

Lastly, there is a currency exchange risk. If the pound were to strengthen against the Malaysian ringgit, this would reduce the sterling value of the company's profits and dividend.

WHEN I'D SELL

CSF is the kind of higher risk/potential high reward investment where, if things did begin to turn sour for the company, it might be necessary to sell and take any loss on the chin.

Conversely, if CSF made satisfactory progress, in line with expectations, and the shares re-rated rapidly to a forward P/E in the mid teens -- producing, perhaps, a 100% gain from 60p as things currently stand -- I'd probably consider it prudent to cash in half the shares and run the rest for free.

As at 7 Feb 2012, G A Chester did not own shares in CSF Group.

RISK WARNING

The articles in Shares 2012 reflect the opinions of the individual writers and give general advice only.

The shares mentioned may not be suitable for any individual.

You should make your own investment decisions, or consult an authorised financial adviser.

- The value of all shares, and the income from them, can fall as well as rise.
- You run an extra risk of losing money when you buy shares in certain smaller companies including “penny shares”.
- There is a big difference between the buying price and the selling price of these shares. If you have to sell them immediately, you may get back much less than you paid for them. The price may change quickly, it may go down as well as up and you may not get back the full amount invested. It may be difficult to sell or realize the investment.
- You should not speculate using money you cannot afford to lose.
- Some securities may be traded in currencies other than sterling, and may also pay dividends in other currencies. Changes in rates of exchange may have an adverse effect on the value of these investments in sterling terms. You should also consult your stockbroker about any additional dealing or administrative charges.
- We have taken all reasonable care to ensure that all statements of fact and opinion contained in this publication are fair and accurate in all material aspects.
- Investors should seek appropriate professional advice from their stockbroker or other adviser if any points are unclear.

ABOUT MOTLEY FOOL SHARES 2012

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