SHARES 2010

The Investor's Guide to the Year Ahead

From The Motley Fool's Top Analysts

The Motley Fool®

To Educate, Amuse & Enrich™

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Design and Production: Sara Klieger and Andy Paul

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Contents

Introduction

BY MAYNARD PATON

DEAR FELLOW FOOL

So that was 2009, a year that started with shares heading into the abyss only to finish with us all having enjoyed a fantastic rebound. I doubt anybody back in January could have foreseen how fast and how far the FTSE indices would rally from their March lows. I hope you were confident enough to buy -- or at least not sell -- during those months of extreme pessimism.

Right now, I can't recall a time when guessing which way the market will go in the year ahead has been more difficult. The rally we've just seen suggests the worst of the financial crisis is over and that we're now well on the road to recovery. However, the economy remains in recession, house prices still look vulnerable and the outcome of the general election might create further nasty surprises. There's every chance England will disappoint (yet again) in the World Cup, too.

OUR 10 FOR 2010

With the market on a knife-edge and all the obvious bargains disappearing, it's looking to me like 2010 will be a year in which informed stock-pickers have the opportunity to once again shine through. So that's where *Shares 2010* can help you. You're going to read about ten great share ideas for next year, ranging from well-known blue chips to somewhat obscure small-caps. We're sure *Shares 2010* can give you and your portfolio a head start for the year ahead.

You may have already heard of some of our selections. Certainly Tesco, GlaxoSmithKline and National Grid should be familiar names, and the three companies are indeed among our ten for 2010. Sometimes you don't have to look too far or be too clever to find a good investment idea. What's more, blue chips can often provide more dependable returns in trickier markets.

But if you're feeling more ambitious, our ten ideas also include a manufacturer of solar-power components, a North Sea oil explorer and an emerging-market fund manager. In the middle ground there are firms involved in telecoms, life assurance, engineering and temporary staffing. We're sure one or two of our ten ideas can interest you.

As you're reading the reviews, however, please bear in mind *Shares 2010* is not a model portfolio. Instead they are favourite ideas from the Fool's most experienced writers, and the ten shares are brought together to help you supplement your existing portfolio. It's up to you whether you buy or not. After all, you're the only person that knows which shares suit you best.

Also please note that these reviews were written in early November and we used 5 November 2009 as the cut off date for the share price and other financial data. Although we've included a buy guide price for each company, you should also check the news issued by each company since early November and its current share price before making any decision to invest, as we cannot guarantee each analysis will be up to date at the time you read this report.

MY OWN TIP

Before you rush off to read the ten reviews, I'd like to share with you my own tip for 2010.

Years ago, I read a short investment article called "The Loser's Game". Essentially the author concluded most investors fared badly in the market because they always spent too much time thinking about which new shares to buy. To improve our returns, the author advised we should all spend a lot more time thinking about which shares to sell.

You see, the author reckoned all the big stock-market trouble we'll ever experience in the near term would not be caused by what we will buy -- but would more likely be caused by shares already sitting in our portfolios! This advice made very good sense to me, and I always recall it at the start of every year.

So before you start to choose potential winners from our *Shares 2010* selections, I'd suggest you first weed out any possible problem shares from your dealing account. Certainly some of your existing holdings may have risen too far, too soon during this year's rally and it may now be prudent to bank some profits -- especially if the underlying businesses are not in the best of health and remain dependent on a full economic recovery.

So with a fully fit portfolio and *Shares 2010* to hand, I'm convinced you'll be in the best shape possible to cope with whatever the economy and the stock market have in store. Pease accept my Foolish best wishes for a successful investing year.

Maynard Paton
Chief Investment Analyst - *Champion Shares PRO*

The Outlook For Profits in 2010

BY DAVID KUO

If 2007 was stock-market heaven, and 2008 was stock-market hell, what does that make 2009?

2009 can perhaps best be described as stock-market limbo. We had some great moments and we had some terrible times. It is little wonder many think investing in shares is nothing more than one big gamble.

IT'S THE LONG TERM THAT COUNTS

But it is important to reflect on the sage words of legendary investor Warren Buffett. He remarked that we should only buy shares that we would be happy to hold if the market were to be shut for the next ten years.

Consequently, it is important to ignore short-term fluctuations in the market and to understand the long-term drivers of share prices. For many people, a year in the stock market doldrums may feel like an eternity, but believe me, it is not. Not if you are prepared to adopt a long-term approach to investing.

In the short term, almost anything can happen and it usually does. However, over the long term, shares are driven by fundamentals. Put another way, if the profits of a business are expected to be higher in future years, then the shares are likely to rise. They may not do so immediately, but eventually they should react.

THE PROSPECTS FOR BLUE CHIPS

Here at The Motley Fool we've looked at recent and forecast profits for all the companies currently in the FTSE 100. The companies in this index make up around 80% by value of the UK stock market.

We found that although some of the UK's biggest companies have recently reported massive losses, profits are forecast to rebound strongly.

	2007	2008	2009	2010
Net profits of FTSE 100 firms	£130bn	£48bn	(f) £115bn	(f) £149bn

In 2007, these 100 companies collectively made a profit of £130bn. But in 2008, their profits crumbled to just £48bn -- a drop of well over 60%.

You won't be at all surprised to hear that the worst profit performers were banks. They slumped to a collective loss of £15bn in 2008. Miners and property companies were also hit hard.

But look at the recovery predicted for 2009 and 2010. Oil, drug and tobacco firms are predicted to continue to prosper, while banks and miners could also regain some ground.

CAN WE BELIEVE THE BROKERS?

Currently, FTSE 100 companies are valued at around 13 times estimated profits for 2009, falling to just 10 times for 2010. On a historic basis, that's relatively cheap and could provide a platform for shares to move higher in 2010.

For many people though, the economy will still look ghastly next year. This is especially true for the millions who will be out of work and for businesses whose performance was flattered by a diet of cheap credit.

We have to say, we are pretty surprised by the high level of profits forecast for 2010. Brokers' forecasts are not always that reliable and the further you look ahead, the less reliable they tend to become.

Could it really be true that profits for these firms will be 15% higher in 2010 than they were in 2007? Even accounting for the fact that around half the profits of FTSE 100 companies come from abroad, this does seem quite remarkable.

When companies start to deliver their annual results in February and March, the picture could become a little clearer. One thing we can say though is that 2010 looks like it will be another 'interesting' year for the stock market!

David Kuo

David Kuo
Investment Commentator - *Champion Shares PRO*

PV Crystalox Solar: Light Up Your Portfolio

BY DAVID HOLDING

PV CRYSTALOX SOLAR

LSE: PVCS
Market: Main
Headquarters: Abingdon, Oxfordshire.
www.pvcrystalox.com

FINANCIAL SNAPSHOT

Recent Price:........................ 66p
Market Cap:..................... £275m
Buy Guidance:..................... 75p
(Data as of 05/11/09)

WHAT IT DOES

PV Crystalox Solar is a FTSE 250 company involved in the production and supply of multicrystalline silicon wafers in the UK and Germany for the solar power industry.

WHY BUY

» Strong balance sheet
» Contrarian nature (sector out of favour)
» Oversold
» Long-term growth prospects
» Major capital investment completed

As long as the sun's still shining, there isn't any real need for an energy crisis. And it doesn't look set to fizzle out just yet. Solar cell producers around the world have long experience in harnessing clean, quiet and renewable power from the sun. And Oxfordshire-based **PV Crystalox Solar** (LSE: PVCS) has a successful track record in providing the silicon ingots and wafers that are the essential components in solar power systems.

That hasn't stopped the shares from losing favour in 2009 and failing to participate in the overall rally. Solar energy just isn't as fashionable with investors as it was a short time ago; a contrarian's delight perhaps. True, there is weaker demand and stiff competition, but this may be reflected fully in the price.

Ignoring the vagaries of the market, the company gives you the impression that it's making solid progress through difficult times, with its eyes firmly fixed on the long term. The solidity of its balance sheet, meanwhile, is also a great source of comfort for the safety-first investors amongst us.

ABOUT THE COMPANY

If you're lying on a beach you aren't usually worried about the world being short of clean power. And -- all being well -- you're very aware of the sun's energy. What you may not realise, though, is that the sand all around you is the key to harnessing that power. This is because sand is the basis for making silicon which in turn forms the basis for solar cells -- and there's no shortage of the stuff -- or of sunshine thankfully. So shareholders; just stay there and relax -- and let others sort it out.

Over 90% of all solar cells produced today are made from single and multicrystalline silicon. All around the world, thin wafers of silicon are processed to form solar cells using semiconductor technology. This enables solar electricity to be generated more or less anywhere, with no moving parts and without harmful emissions of CO_2 or other pollutants. Solar cells made of crystalline silicon have a life expectancy of over 20 years. They recover the production energy required to make them many times over.

PV Crystalox Solar is one of the world's biggest manufacturers of these multicrystalline silicon ingots and wafers. The company was formed by the merger of Crystalox Ltd in Wantage and PV Silicon AG in Erfurt, Germany. Over the last decade or so, it has been growing like topsy, and floated on the London market in June 2007, raising money for in-house silicon production and to further expand its international business. It makes silicon ingots in Oxfordshire, with parts of its output shipped to Japan, where they are sold as wafers after processing by a sub-contractor. A second part of the production is processed into wafers for European customers at the group's facilities in Erfurt, in Germany. And now there's a brand new polysilicon production facility which has been up and running in Germany since last July. The new plant is expected to significantly reduce production costs.

The company is now working with top solar cell producers on the next generation of wafers, particularly ultra-thin wafers. The ultimate aim is to reduce the cost and efficiency of the wafers every year through the company's own silicon feedstock, to help make solar electricity competitive with conventional electricity.

This is all very well, but the best laid plans of mice n' men and all that mean it's been a bit of a bumpy ride for shareholders following a positively blistering start to listed life. When everything was hunky-dory, the shares reached £2 in the summer of 2008. But the worldwide economic slump saw a fall-off in demand just at a time when suppliers were still increasing capacity. Sales and profits fell and so did the share price. The company is now facing up to the harsh realities of a world in which there is a distinct mismatch between supply and demand. But fear not; this may be an opportunity, not a threat.

INVESTMENT THESIS

As you'll probably have gathered, I see PV Crystalox Solar as an excellent recovery play. This isn't so much a recovery in the company, though, as in wider markets and *perceptions* of value. After all, it has put in a defiantly robust performance, so far, in difficult circumstances. I see it as a chance to buy a leading edge company in a long-term growth market at an exciting stage in its development at a low, low price which has been driven down more by sentiment than by fundamentals. This is classic Foolish investing territory for me.

Undoubtedly, the company is feeling the effects of the recession and the fall-off in demand, which has affected prices. And this does look likely to continue for a while yet. But the price to which the company's shares have fallen simply looks overdone given the prospects for recovery combined with strength in the balance sheet.

Its new facility at Bittersfield in Germany should improve quality and lower costs -- and it's been up and running since July, so this is no "jam-tomorrow" faux promise. Hopefully, the new facility will feed through to the bottom line in fairly short order as worldwide demand picks up again -- along with the company's share price.

This company is also cash-generative and has completed its major capital expenditure via the investment in the Bittersfield plant -- which it brought in on schedule and within budget.

OK, the downside is that there may well be worldwide over-capacity, but there may be a lag in demand as that's what happens in a recession; you defer spending until things are looking rosier and the solar cell world moves on like any other (most existing cells need replacing every 10 years or so). And maybe some of the weaker suppliers will go to the wall -- though I don't believe PV Crystalox Solar will be one of them.

There could also be an increase in demand not yet reflected in the latest figures after this year's oil price recovery.

And this firm has a long track record in the supply of ingots and wafers. It is a tried, tested, and trusted company that works with its major blue-chip customers on long-term projects to improve efficiencies and to make better products. This shouldn't be undervalued.

FINANCIALS AND VALUATION

At 66p, PVCS is valued at £275m. Meanwhile, the company's net asset value -- virtually all of which is made up of tangible assets and which includes freehold land, plant & machinery, inventory, and a very healthy dollop of cash of €92.4m -- is worth around 85% of the total market capitalisation at the time of writing.

Following another value tenet; the yield, meanwhile, is big. It's big enough for the market to imply it can't be maintained and this *may* prove to be correct. The company's final dividend will be based on its second-half performance about which we haven't had any new clues at the time of writing. *If* the company feels able to maintain last year's dividend, then the shares will be yielding over 6%.

The historic price-to-earnings ratio is almost comically low, at less than three based on 2008 earnings. This falls to a little over two against enterprise value, stripping out the cash. But then history is bunk. However, as and when the photovoltaic market picks up, I am expecting the company will revert to previous levels of profitability. In fact, it could surpass them given time as the Bittersfield plant begins to pay back and -- possibly -- the weaker players exit the supply side of the equation. Only time will tell. But whatever way you look at it, the current valuation factors in a heck of a lot of bad news.

RISKS

Government incentives around the globe are critical to the development of the solar electricity industry. The global recession has seen pump-priming by governments on a huge scale -- and this could lead to spending cuts including subsidies and tax incentives which currently help stimulate demand. Similarly, the continuation of economic uncertainty and credit restrictions won't do much to aid demand for the foreseeable future. And it's the fall-off in demand that has already impacted badly on the company.

PV Crystalox Solar is also reliant on a relatively small number of customers, which is never a great position to be in, whilst production problems at its own plants or its Japanese sub-contractor's plant would adversely affect the supply side of the equation -- where, as we know, there is already fierce competition.

Then there's the wider competition in renewable energy from wind farms, tidal barriers, hydro-electric power and the like. The 'fashion' element to these matters is important to global demand. If solar falls out of favour for some reason, the company as a bit of a 'one trick pony' will suffer.

WHEN I'D SELL

By my slide rule, the shares look undervalued to the tune of somewhere over 50%. It's a simple matter, therefore, for me; I'd sell if and when the shares reach £1 in the relatively short term, unless the picture has changed substantially by then, for whatever reason.

But I also see the company as a good prospect for the very long term, so if the story unfolds gradually, and there's only a slow and steady increase in price, I may stay with it longer term and enjoy the yield. Given further short-term bad news -- which wouldn't come as huge surprise -- I'll almost certainly average down as there's value here.

FOOLISH BOTTOM LINE

With 85% of the value covered by tangible assets and cash, and the company suffering what I see as a temporary distaste by investors for solar energy, the shares look a classic Foolish buy to my mind.

Solar power is, in my very unscientific and overly-simplistic opinion, the best basis for the future of renewable energy. But I prefer to look at the numbers than to try and make scientific judgements, and these make a lot of sense as an investment for my money at the current level. This company has been way oversold – it's simply one of those times when the market has it wrong.

Disclosure: As of 5 November 2009, David Holding had a beneficial interest in PV Crystalox Solar

Goodwin: Family Engineering Global Success

BY OWAIN BENNALLACK

COMPANY NAME

LSE: GDWN
Market: Main
Headquarters: Stoke-on-Trent
www.goodwingroup.com

FINANCIAL SNAPSHOT

Recent Price:........................1,038p
Market Cap:..........................£75m
Buy Guidance:....................1,100p
(Data as of 05/11/09)

WHAT IT DOES

Mechanical and refractory engineering, especially for the energy industry

WHY BUY

- Leading supplier of critical parts to important energy sector
- Excellent long-term growth and sales record
- Experienced, family-led boardroom with experience of tough markets

Britain has become a nation of hairdressers, shopkeepers and bankers. The industrial heartland has gone, and the high-tech industry that might have replaced it makes ephemeral software or sells designs for chips someone else makes. We don't get our hands dirty anymore, right?

Wrong. Contrary to perception, Britain boasts large, specialised manufacturers with factories in the UK supplying customers across the globe.

Three of the biggest listed are **Rolls-Royce** (LSE: RR), **Rotork** (LSE: ROR) and **Renishaw** (LSE: RSW). Smaller -- but catching up -- is **Goodwin** (LSE: GDWN).

Five years ago Goodwin shares were 250p, and the company was valued at less than £20 million. Today its value is four-fold higher, reflecting strongly growing sales efficiently converted into rising profits and dividends.

ABOUT THE COMPANY

Goodwin is made up of various subsidiaries, divided into two broad operating groups:

Mechanical Engineering	Refractory Engineering
Goodwin Steel Castings Ltd	Dupré Minerals Ltd
Goodwin International Ltd	Hoben International Ltd
Noreva GmbH	Goodwin Refractory Services Ltd
Easat Antennas Ltd	Siam Casting Powders Ltd
Goodwin Korea Limited	Gold Star Powders Ltd
Goodwin India Private Ltd	Ultratec Guangzhou
Goodwin Valves Shanghai Ltd	Gold Star Brazil
Internet Central	-

Source: Goodwin investor presentation: March 2009

Mechanical engineering dominates Goodwin's revenues -- as of March 2009 it contributed 82% to turnover, with the balance coming from the refractory side.

The most significant business area is high-precision bespoke steel and alloy castings, which Goodwin supplies to various projects, ranging from a $7m order for castings to secure cables on California's Oakland Bay suspension bridge to parts for power generation facilities across the globe.

The 2009 Annual Report provides a geographical breakdown of revenues:

Region	Revenue (£m)
UK	17.0
Rest of Europe	23.3
USA	12.3
Pacific Basin	27.0
Rest of World	21.1
Total	100.7

Source: 2009 Annual report

Yet this is not an overnight success story. Founded in 1883 as R Goodwin & Sons Engineers, it was listed on the London Stock Exchange in 1958.

Fifty-one years later, the company remains under the control of the Goodwin family, who own 52% of the shares. The boardroom too is dominated by Goodwins, led by chairman John W. Goodwin and managing director Richard Goodwin. That partnership has been in place since 1992, delivering excellent gains for shareholders.

Management appears to enjoy good relations with employees, too. The company's Stoke-on-Trent subsidiary, Goodwin International, which produces industrial check values, employs three shifts for non-stop operation, and Goodwin says it hasn't suffered a strike in 25 years.

I see these strengths reflected in Goodwin's financial performance:

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Revenue	100.7	80.6	65.3	58.2	44.9
Pre-tax profit	13.1	9.8	7.0	5.1	3.5
Earnings per share	121.9p	91.1p	65.1p	46.7p	34.4p

Source: Goodwin website / 2009 Annual Report

The group has no share options or other diluting interests, hence there is no difference between basic and diluted earnings per share.

INVESTMENT THESIS

Sometimes stock pickers suggest a share that is unusually under-appreciated by the market. Alternatively, an investor may believe a new product or service will transform a company's fortunes, opening a brief window to profit.

I don't see the case for Goodwin as fitting either category. Rather, in my opinion to make an investment into Goodwin is to follow Warren Buffet's modus operandi: "To buy great companies at reasonable prices".

I argue Goodwin has a proven record of delivering shareholder value. Its latest full-year results saw the company report pre-tax profit growth of 33.6% and turnover up 25%. But these were not one year's isolated results. In the 15 years prior to this year's figures, the company says annual compound profit growth was in excess of 21% and annual compound turnover growth was over 10%.

I believe this performance can continue. The steady increase in sales shows Goodwin's products are in demand, while the global reach and 'mission critical' nature of many of its products suggests they cannot easily be substituted for cheaper alternatives.

I like Goodwin's management, particularly the dovetailing of a majority family shareholding and boardroom control. The absence of share options means there should be no artificial boosting to hit short-term targets; shareholders and the Goodwin family's long-term interests are aligned around a sustainably higher share price.

Family management would be detrimental if not of sufficient calibre, but I believe Goodwin's management has proven itself in the figures I've quoted. For more specific evidence, consider Goodwin's purchase of rival German valve manufacturer Noreva in March 2007. Goodwin bought Noreva for £5m (without recourse to debt). In the past year, pre-tax profits doubled to £3.1m, suggesting Goodwin's management paid a keen price and improved how Noreva is run.
The acquisition could soon pay for itself.

In my view, management's decision a year ago to reduce group debt levels to zero in light of the global slowdown -- and the subsequent fulfilment of this ambition -- is further evidence of dependable hands.

Looking to that wider economic picture, the weak pound should help Goodwin's competitive position. The company was thriving when the pound was higher against a basket of global currencies. With the pound weaker, Goodwin's Sterling-denominated prices should be keener and/or its margins improved, which may offset some slowdown in sales.

I like the fact that Goodwin's earnings aren't reliant on the UK economy. With nearly 50% of turnover coming from outside of the UK, Europe and the US, the company can benefit from the faster-growing regions of the world.

While Goodwin has cautioned investors not to expect growth this year, there could be some positive developments. The refractory group of companies has now been consolidated; this done, management can focus on running them.
The chairman said in the most recent results that he expected "profits of the refractory engineering division to significantly increase" now consolidation was complete.

FINANCIALS AND VALUATION

What value does the stock market put on Goodwin's long record of steady success? With the shares at 1,038p, on last year's earnings per share of 121.9p to April 2009, the historical P/E rating is just 8.5.

It's true no forecasts are available for 2009/10 and the company itself expects no profit growth due to the economic slowdown. The first quarter of the 2009/10 year showed turnover and profits up slightly, but earnings per share dropping a fraction to 22.9p per share.

Goodwin isn't a particularly seasonable business, so we could assume the first quarter is an indication of what's to come over the full year, resulting in earnings of around 100p per share, for a prospective P/E of 10.4.

In contrast, fellow engineer Renishaw is on a far higher prospective P/E of well over 40 (according to Digital Look data), while Rotork is on a P/E of 17.5.

RISKS

Goodwin is a modern, specialised engineer operating in many different areas, but the question isn't whether its earnings are cyclical -- it's to what extent they are. So far Goodwin has held up well, but its critical castings and valves are specialised products with a long lead time to manufacture.

I would expect trouble to show up first in a lack of new orders rather than a sudden drop in turnover. Goodwin companies began the year with order books of £57m, which the chairman claimed "should allow [for] a good performance in the new financial year".

Some investors may not like family-dominated boardrooms; Goodwin is not for them. Nor does Goodwin always comply with so-called best practice in corporate governance -- for example, it has no non-executive directors. There is no separate audit committee, remuneration committee or nomination committee. Goodwin argues they're inefficient.

One definite issue is the large bid/offer spread. As I write this is 45p, equating to an immediate 4% loss on buying. Not unusual for a small cap, but not desirable.

The shares are rather illiquid, too, so you may not be able to sell a large holding without affecting the price.

WHEN I'D SELL

I'm recommending Goodwin as a Warren Buffett style buy-and-hold investment, so I don't have a specific price target or a P/E re-rating in mind for an exit.

In contrast, I'd monitor the business and sell if I thought that any deterioration in trading suggested long-term structural or operational difficulties, rather than simply a wider economic malaise.

Signs that Goodwin's companies were losing their niche leadership position would be a definite warning, as I don't think it can compete on price alone. This might show up in deterioration in margins or return on capital employed, or a growing reliance on debt to cover poor performance.

FOOLISH BOTTOM LINE

Goodwin's chairman and MD are 58 and 55 respectively, which should mean stability and expertise in the boardroom for another decade. With the world's energy needs only increasing, I believe demand for Goodwin's core products should remain strong over the longer term, making now an opportune time to take a stake in a well-run, keenly-priced UK company before growth resumes.

Disclosure: As of 5 November 2009, Owain Bennallack owned shares in Goodwin.

National Grid: A Secure and Rising Income

BY TONY LUCKETT

NATIONAL GRID

LSE: NG
Market: Main
Headquarters: London
www.nationalgrid.com

FINANCIAL SNAPSHOT

Recent Price: 615p
Market Cap: £15.1bn
Buy Guidance: 680p
(Data as of 05/11/09)

WHAT IT DOES

National Grid runs the electricity grid and gas pipeline network in the UK and also has operations in the US.

WHY BUY

- Huge barriers to entry
- High and rising dividends
- Demand for energy increasing
- Alternative energy producers will need its networks

The father of pessimism, Arthur Schopenhauer, said that *life swings like a pendulum backward and forward between pain and boredom*. Global stock markets have inflicted much pain upon investors in the last couple of years; many investors would welcome a respite from the pain with a bit of boredom!

One way to provide this is to have a few shares in your portfolio of a company which supplies goods and services that should not go out of fashion because they are essential to modern life. The Anglo-American company **National Grid** (LSE: NG) is one such firm, providing large-scale electricity transmission and gas distribution services in Britain and the New England region of America.

National Grid's shares are suited for income-seeking investors who are looking for a high dividend, currently 5.8%, that should keep pace with inflation and should also provide some modest capital growth prospects.

Thanks largely to fears that the recession has severely reduced the demand for gas and electricity its shares have been out of favour this year, falling by almost 10% compared with the FTSE 100's gain of about 19%. As America and Britain emerge from their respective recessions this may present investors with a buying opportunity.

ABOUT THE COMPANY

National Grid's primary businesses are the English and Welsh electricity transmission grid, the National Transmission System which distributes gas from port terminals to power stations and four of the eight British regional gas distribution networks. Its American businesses consist of the electricity transmission grid and the gas pipeline network for the city of New York and much of New England together with being the operator of the Long Island electricity grid which includes running 57 power stations. It also owns and operates the electricity interconnectors between England and France as well as between Canada and New England.

National Grid's regulated monopolies dominate its finances; in 2008/2009 they produced over 97% of its operating profits.

INVESTMENT THESIS

My argument for National Grid shares is that its ownership of geographic monopolies, which are resilient to both technological change and displacement by new competitors, has created a stable business with good long-term prospects.

National Grid's customers, the electricity generators and gas supply companies must use its networks to distribute gas and electricity to their customers. Whilst its American businesses involve some electricity generation and gas sales, distribution provided more than 88% of National Grid's operating profits for 2008/2009.

Anyone wishing to build a competing gas or electricity network must overcome the substantial problem of obtaining the land planning permission for thousands of miles of cables and pipes. Overhead power cables create enough of a debate today; no-one is going to find it easy to build a second network anytime soon!

National Grid's networks use technologies which are unlikely to be seriously challenged for decades, if ever. The laws of physics make it uneconomic to wirelessly transmit large quantities of electricity over anything but short distances because of massive power losses and health and safety concerns (akin to an unshielded multi-megawatt microwave oven). Mobile electricity companies shouldn't be able to have the same effect as the mobile phone companies have had upon the fixed-line operators.

Electricity transmission is a completely different business from electricity generation. This is an important distinction because in the next decade many new types of power plant (mostly wind, tidal and solar power) will come online as governments around the world promote renewable energy sources. But these new power plants will still have to use National Grid to deliver power to their customers!

Small-scale gas production is a complete non-starter and bottled gas distribution is mostly used to supply customers who aren't connected to a gas distribution network. Any new gas supply company which doesn't use bottled gas must use the gas pipeline networks to get gas to their customers. The biggest risk is that customers may switch away from gas to alternative fuels.

The most likely small-scale change will be local electricity production from solar panels or using genetically modified plants to produce electricity from photosynthesis, but large-scale electricity consumption needs large-scale production and thus the cables and pipes are here to stay.

If room temperature superconductors are ever discovered, National Grid remains in the driving seat because it would simply swap its existing cables for superconducting cables. In contrast any potential competitors would still have the problems of obtaining land and planning permission.

FINANCIALS AND VALUATION

National Grid is a capital-intensive business; it has £44.4bn of assets whilst its total liabilities are £40.5bn of which £23.5bn is long-term debt. A high level of borrowings is quite normal for a regulated utility with a largely captive customer base.

National Grid has bought and sold many businesses in recent years, most notably the sale of four of the eight British gas distribution networks and the purchase of its American businesses (some parts of which have subsequently been sold). The effect of these deals, when combined with some significant restructuring costs, has made National Grid's earnings per share extremely volatile over this period. Most notably the disposals in 2006 and 2008 crystallised one-off profits which were larger than those generated by the operating businesses!

Below is a table summarising National Grid's earnings per share (eps) and dividends for the last five years, all of which can be found in the company's annual reports.

Year ending 31 March	2009	2008	2007	2006	2005
Adjusted (ongoing) eps	50.9p	47.8p	38.3p	35.2p	32.3p
Dividend	35.64p	33.0p	28.7p	26.1p	23.7p
Headline diluted eps	38.2p	121.6p	50.9p	135.0p	46.0p

Using different earnings per share figures is something that I would normally disapprove of, preferring instead to use the "warts and all" diluted eps. However, in National Grid's case the company's preferred measure, the adjusted eps, removes much of the effects of the purchases, disposals and restructuring costs which would otherwise mask the steady growth in earnings per share produced by the underlying businesses. It's the future we look towards, not the past.

National Grid's interim management statement for the first quarter of 2009 (April to July) started with the reassuring statement that "National Grid continues to trade in line with our expectations of delivering a strong performance in 2009/10 across our businesses." The statement goes on to confirm that management is targeting an 8% annual dividend increase until March 2012.

National Grid's interim results were issued on 19 November, a couple of weeks after our formal cut-off date for *Shares 2010*. They showed a 31% increase in earnings per share and an 8% dividend increase. It was described as "a very good start to what is expected to be a strong financial year". Clearly the recession has not particularly affected the demand for gas and electricity.

As a privatised utility it's no surprise to see that National Grid has a sizeable final salary pension scheme (£14.8bn of assets) with a modest deficit (£1.2bn). However, in the light of the performance of world stockmarkets in 2009 I wouldn't be surprised to see that much of this deficit has been cleared.

RISKS

Like most utility companies, the most significant influence on National Grid's businesses comes from its British and American regulators. In Britain the regulators have restricted all price increases using a formula which is based on the retail prices index; until the end of March 2013 prices can be increased by RPI+4.4%.

In contrast American regulators use "rate of return regulation" which limits the percentage return earned upon the capital employed in the business. Currently National Grid keeps all profits up to a certain return, generally between 9.5% and 13% depending upon the business, with any excess returns being shared with its customers in pre-determined proportions.

Regulators also have the power to impose other conditions, such as renewable energy targets, which could impose significant costs upon National Grid's businesses. Should regulators on either side of the Atlantic impose stricter terms than anticipated when the next reviews are due, this would definitely harm the share price.

National Grid's profitability is largely determined by the demand for gas and electricity in Britain and east coast America. This in turn is related to the broader performance of the economy so if demand falls then so will its profits.

WHEN I'D SELL

A strong sell signal would be if the yield ever comes close to that on the risk-free benchmark of long-dated index-linked gilts. But given the parlous nature of the public finances it is quite possible that one day government debt will have a lower credit rating than that of high-quality corporate debt!

Another sell signal would be if the regulators started behaving extremely harshly or if the company encounters problems in rescheduling its debts.

FOOLISH BOTTOM LINE

My view is that National Grid shares represent a good long-term holding for income-seeking investors.

Electricity is essential to modern civilisation and gas follows closely behind. People will always want electricity and, to a lesser extent gas, otherwise civilisation would fall and then you'd have far bigger problems than worthless shares!

National Grid's monopoly over the delivery of gas and electricity to homes and businesses ensures that its shares should continue to provide investors with a relatively secure and rising income for years to come.

Disclosure: As at 5 November 2009,Tony owned shares in National Grid.

Hansard Global: Creating Wealth for Investors

BY STEVE SCOTT

HANSARD GLOBAL

LSE: HSD
Market: Main
Headquarters: Isle Of Man
www.hansard.com

FINANCIAL SNAPSHOT

Recent Price:........................ 175p
Market Cap:...................... £240m
Buy Guidance:.....................212p
(Data as of 05/11/09)

WHAT IT DOES

Hansard is a specialist long-term savings provider, offering a range of products within a life assurance wrapper that are designed to appeal to affluent international investors.

WHY BUY

- Exposed to a long-term growth market
- Shareholder-friendly management
- Low-risk business model
- Flush with cash

Wealth management expert, **Hansard Global** (LSE: HSD), is one of those companies that never attracts much publicity. It makes no acquisitions and announces no new contracts. Its accounts are long and full of detail and analysis. Yet if you are put off by this and think that Hansard is just a boring company, too hard to understand and full of investment risk, then I believe you are mistaken. Hansard seems well placed not only to deliver long-term wealth management for its customers, but also to its shareholders.

ABOUT THE COMPANY

Hansard was floated on the main market of the London Stock Exchange in December 2006 at 260 pence a share, giving it a market capitalisation of £357m. Despite its low profile, this is no minnow or illiquid small cap company.

Hansard is a specialist, long term savings provider. As its website says, it offers a range of flexible and tax efficient investment products, designed specifically to appeal to affluent investors. For tax reasons these products are sold within a life assurance wrapper, designed to mirror the performance of the underlying investments.

However to understand the attractions of Hansard as an investment opportunity it is important to understand what Hansard is not.

It is not a financial advisor. Hansard sells its products exclusively through over 540 financial services intermediaries, independent financial advisers and the retail operations of certain financial institutions. Hansard, itself, provides no financial advice.

It is not a fund manager. It does not, itself, invest the funds. Instead it provides access to over 240 third party investment funds from which the intermediaries may choose and create a portfolio to meet their client's financial objectives.

It is not even really a life assurer. The life assurance wrapper is merely a method of offering policyholders exposure to a wide range of investment opportunities in a tax-efficient manner. It is the policyholders who bear the investment risk arising from the contracts, as the policy benefits are directly linked to the value of the assets.

Hansard in effect provides the bit in the middle of all of this which makes it work. It does it through an award-winning, multi-language internet platform which allows intermediaries to keep track of the business their clients have with the group, segment their existing client bases effectively, and provide tailored reporting to clients. It is the strength of Hansard's relationship with these intermediaries, and the service it provides working with them, that gives Hansard its competitive advantage.

On 30 June 2009 Hansard had £1.0 billion under administration with 43,000 policyholders in 170 countries in Western Europe, the Far East, Latin America and the Middle East. This is a truly international business.

It is a business overseen by 42 per cent shareholder, Leonard Polonsky, who founded the Group in 1970; a business which has therefore demonstrated its sustainability and strength over four decades of operation.

INVESTMENT THESIS

Despite the volatility in world stock markets, wealth management is still an industry with long-term growth potential. Entrepreneurs in emerging nations have an attitude towards saving which is sadly lacking in the West. Even in the West there is a growing desire to protect wealth from tax and future inflation.

Hansard is a strong player in an attractive market. It continues to invest in the scalable internet platform which supports its low cost distribution model. Selling entirely through intermediates Hansard carries no fixed-cost sales network.

Indeed Hansard's business model is specifically designed to reduce risk and facilitate profitable growth. Its assets are not at risk from any liability for poor investment advice or from poor investment performance.

It is run by a board which has an attitude towards remuneration which would put many small caps to shame. Last year Executive Chairman Polonsky drew a salary of £1. Managing director, Gordon Marr, drew a salary of less than £200,000. There were no bonuses, fancy extras or big share option awards. Furthermore to recognise exiting difficult market conditions, directors and senior executives have agreed to take a 5 percent pay cut and accept a holiday in pension contributions for next year.

In contrast shareholders got a 5 percent increase in their dividend. That's an admirable order of priorities.

Yet despite putting barely a foot wrong since its flotation and indeed increasing its dividend by 26 percent in just three years, Hansard has seen its share price fall by nearly a third to 175 pence. That looks to me like an opportunity to get into a quality business at a good price.

FINANCIALS AND VALUATION

Despite the uncertainty and volatility in stock markets, Hansard's performance has remained solidly robust and broker Panmure Gordon is forecasting this to continue:

Year ended 30 June	Earnings per share	Dividends per share
2007	14.4p	10.0p
2008	17.0p	12.0p
2009	14.7p	12.6p
2010 Forecast	14.9p	13.2p
2011 Forecast	17.5p	14.6p

At the current share price of 175 pence, that's a price earnings ratio of 11.9 dropping to 10.0 by 2011. That's a rating which I don't believe reflects Hansard's long-term growth prospects. In particular however it fails to reflect Hansard's substantial cash assets which at 30 June 2009 amounted to 55 pence a share; nearly a third of the share price.

Shareholders also benefit from a very generous dividend, which currently puts the share on a yield of 7.2 percent; a dividend which is forecast to rise by over 5 percent a year for the next two years. Indeed Hansard has made a specific commitment to pay out at least 70 percent of its earnings as dividends. Yet, despite the fall in earnings in 2009, it still chose to raise dividends in 2009 by 5 percent; a clear sign of Hansard's confidence in the future.

A yield at this sort of level suggests the stock market has concern over its sustainability. Yet not only is the dividend covered by earnings but Hansard has very strong cashflow. Based in the Isle of Man, it pays no tax. It also has little working capital and almost no fixed assets. Finally of course those dividends are supported by a cash balance which would alone fund payments for the next 4 years. Barring a catastrophe there is little reason to believe the dividend will be cut.

Hansard also produces an adjusted net asset value, the so called European Embedded Value (EEV), which takes account of future profits under the insurance policies it has in place at the balance sheet date.

Hansard's EEV at 30 June 2009 was 172.3 pence compared to a share price of 175 pence. In effect the share price is placing little or no value on any new business Hansard will receive in future years.

RISKS

Despite its performance Hansard would not be immune to a long-term bear market. Hansard receives funds from both regular investment and one off premiums. If the returns from investments in the future look poor, then inevitably wealthy investors will be less inclined to put their money into such vehicles.

Hansard also benefits from its ability to shelter investments in a tax efficient life assurance wrapper. If these schemes came under threat from worldwide tax authorities then it is inevitable that Hansard's products would be less attractive. However the geographical diversity of Hansard's clients across 170 countries spreads the risk of that.

Resident in the Isle of Man, Hansard benefits from a zero corporation tax rate. However this doesn't look to be under serious immediate threat. Recently the OECD effectively accepted the Isle of Man's status as a 'tax haven' by including it on the white list of countries complying with global standards of tax co-operation and exchange of information.

WHEN I'D SELL

The key for Hansard is maintaining and growing its dividend whilst at least maintaining its cash balances and EEV. If the dividend is cut or maintained at the expense of significant erosion of cash or EEV then I would have to rethink my investment thesis.

Anything which undermines Hansard's business model as a provider of tax efficient investment products would also be a cause for concern.

Hansard's share price has been rising slowly from a low of 120 pence in mid June. I'd consider a share price either 25 percent higher than EEV or giving a dividend yield less than 5 percent as signs that the price was moving into fully valued status. At the moment that would be around 212 pence, although with the interim results expected in February that could be subject to revision.

FOOLISH BOTTOM LINE

Hansard's is one of those companies which keep quietly building their business and delivering shareholder value. With a covered dividend yield of 7.2 percent and a progressive dividend policy, backed by substantial cash assets and embedded value, there's little more to do than sit back and let the money roll in. Management can be trusted not to do anything risky and once investor confidence returns, I'm hoping profits and the share price will start to motor.

Nautical Petroleum: Slowly but Surely

BY DAVID HOLDING

NAUTICAL PETROLEUM

LSE: NPE
Market: AIM
Headquarters: London
www.nauticalpetroleum.com

FINANCIAL SNAPSHOT

Recent Price:........................60.5p
Market Cap:......................£38.3m
Buy Guidance: **80p**
(Data as of 05/11/09)

WHAT IT DOES

Nautical is a specialist in heavy oil exploration, development and production in the UK (North Sea) and Europe

WHY BUY

- Excellent track record in deal-making
- Strong balance sheet
- Exciting potential
- Steady growth

The world's main economic driver over the last decade or so has been the rapid growth of the planet's two most populated economies. Granted, this has taken a bit of a breather of late, but I don't see the basic pattern changing and the latest economic data suggests it's already back on track.

In turn, this has been one of the main drivers in the increase in the price of oil, despite its big-dipper like drop in the latter half of 2008 and early 2009. World crude oil demand grew an average of 1.8% per year from 1994 to 2006, whilst China has seen its oil consumption grow by 8% yearly since 2002, doubling from 1996-2006. Consequently, the world has been busy trying to find new oil as well as alternative power sources. The UK's North Sea oil production peaked in 1999 since when it has roughly halved. But this hasn't bothered some exploration and production companies in the area who think there are still new finds to be made.

One such company is heavy oil specialist **Nautical Petroleum** (LSE: NPE). Nautical has various operations mainly in the North Sea, though it also has interests in France. This is a company which I feel has its feet solidly on the ground, steadily building value through acquisitions, farm-in agreements and licensing rounds. Don't expect fireworks -- but it should make steady progress.

ABOUT THE COMPANY

Nautical was listed on AIM in April 2005, since when it has been led by CEO Steve Jenkins. Its stated intention is to become a significant producer of heavy oil, initially in the United Kingdom Continental Shelf (UKCS) and in Europe. It spreads its exploration risks through relationships with other oil companies. It's already made an impressive start.

Nautical began to put together its portfolio in the early 2000s, first in the North Sea and then in Europe. Heavy oil used to be unpopular because it was difficult to extract and sold at a discount to conventional crude oil. That has changed, given generally higher oil prices and technology improvements, and the price gap has narrowed considerably, to around a 10% difference. What this means in practice is older heavy oil discoveries that remained undeveloped have gradually become more economically viable.

The company currently has a total of 25 blocks on 18 licences in a combination of development, appraisal and exploration acreage, of which 11 blocks (8 licences) are operated by Nautical alone, though it intends to reduce this through relinquishments of blocks with what it considers to be the least favourable prospects, so allowing greater resources to be directed towards the most promising blocks.

Nautical has had its share of setbacks as one would expect with any explorer. Generally disappointing drilling results occurred between November 2007 and October 2008, but the company's exposure was minimised due to the farm-out arrangements it had in place.

The main value at the moment lies in Nautical's Kraken and Mariner prospects -- though other prospects seemingly have excellent long-term potential. The Mariner prospect (operated by StatoilHydro) in which Nautical has a 26.67% stake, has recently been the subject of seismic surveys which have brought cheer to us shareholders as the company said: "All the signs are that the Mariner development is economically robust and moving inexorably forward to project sanction and FDP (Field Development Plan) submission in 2011 with first oil in 2015". Statoil estimates the prospect's Maureen and Heimdal reservoirs at 90 million barrels of oil (mmbo) net.

Meanwhile, the Kraken prospect (where Nautical is the operator, and where it has drilled two appraisal wells, the latest of which was spudded in September 2008) has 40mmbo net best estimate contingent resources and is expected to start production in 2011. Nautical has a 35% share of Kraken.

INVESTMENT THESIS

Nautical ticks a lot of boxes for Foolish investors long enough in the tooth to have seen so many potentially "exciting" exploration companies come and go over the years.

There's a lot to try and get your head around when looking at oil companies and I don't pretend to understand them half as well as many other investors with far greater expertise in this area. But I understand cash, and what I like about Nautical is its balance sheet. Investors at today's price are effectively buying a number of exciting possibilities for free. Nautical comes across as a sensibly run oil company that doesn't try to get investors overly excited on any kind of false premise. Instead, it's honest and shrewd in its approach to farm-out / farm-in agreements.

Investors must accept that exploration is a risky business and any oil explorer is liable to disappoint. But Nautical's share price looks very well underpinned by assets for my money. Overall, it strikes me as a company that quietly makes progress on its operations, winning a few, losing a few, but doing what is required to steadily build good value.

It would also make a tasty potential morsel for a bigger oil company, so there's the ever-present possibility of a takeover at a decent premium. Given its mainly institutional ownership profile (International Energy Group AG, which was instrumental in establishing Nautical, owns 31%) it would be relatively easy for a predator to determine a price at which a bid may be successful.

What may deter some investors is the fact that production is still a way off, so it's definitely one for the patient investors amongst us. It's all about balancing risk and reward, and the odds here look well stacked in investors' favour.

FINANCIALS AND VALUATION

At 60.5p, the company is valued at a little over £38m. In exchange for a purchase at the current price, investors receive net assets of almost £60m, including over £19m in cash at the last count, with zero debt.

The cash level was bolstered in the second half of 2008 by £11.5m from farm-out deals to other oil companies, of which £7.5m was spent on the continued exploration and evaluation of assets. Such a track record in preserving and generating cash is important in assuring investors that this is a company that truly puts the interests of its shareholders first.

At the time of the Budget in April 2009, the company told us that it expects the corporation tax breaks announced to enhance the value of its 35% share of Kraken by £56m and of its 26.67% share of Mariner by £43m. And in August 2009 broker and researcher Tristone Capital came up with its estimation of net asset value at 118p a share for Nautical -- based on the Mariner and Kraken prospects. This is all educated guesswork, of course, based on the likely future direction of the oil price and the best estimates of success based on seismic data, but it seems a reasonable target.

RISKS

The main risks are the same as those of any oil explorer; Nautical might have a few exploration failures. It probably will in fact. And its biggest reservoir prospects may not perform as well as anticipated. Also, the oil price could plummet again due to unforeseen economic factors, as it did in 2008-09. If such adversity does affect the company, there could then be a gradual erosion of value through increased operating costs and the lack of potential for further farm-out agreements. And such agreements themselves come with risk -- as does any commercial venture with third parties.

The wider economy remains fragile, too. Although confidence is gradually returning and Nautical has lived up to its nomenclature and weathered the storm very ably so far, we've seen how quickly such confidence can run aground in recent times.

If such events occur at a time when the company is looking to raise new capital to take advantage of some of its best prospects, this could well pose a problem. To progress, Nautical will not only need successful results from its best prospects, but it will also need to be able to raise money via debt and/or equity funding.

Meanwhile, changes in the currently favourable taxation policy wouldn't be good news for investors.

WHEN I'D SELL

With Nautical, this is a difficult one. I believe they'll build value steadily through shrewd farm-out agreements and that Mariner and Kraken alone are worth far in excess of the current share price. However, it's often said it's never wrong to take a profit. All I would say in this case is that it's also important not to call "bank!" too early. After all, the management has an excellent track record in building value for the company and, therefore, shareholders.

But, in the spirit of nailing one's colours to the mast, we all invest for the profits, so how about selling half if and when Nautical reach 120p? This would seem a reasonable tactic to me -- selling half to get one's money back come-what-may with what is, after all, an exploration company, and running the rest for free to see what happens in the long run.

On the downside, the nature of exploration companies means that it's usually too late to sell by the time the bad news is out. Any sign of significant director selling would ring alarm bells -- as would the departure of the CEO.

FOOLISH BOTTOM LINE

What I like about Nautical overall is that it offers a fair amount of excitement with a reasonable degree of downside protection. As part of a balanced portfolio, which in my own case is largely value-led with relatively little exposure to oil exploration stocks, Nautical brings a welcome whiff of excitement.

Although we live in an uncertain world, I would still be surprised if I could sleep for five years and find out the share price hadn't risen substantially -- unless the company had been taken out before the share price had chance to do so. Given the cash position and asset backing, I'm quite happy to let the experts get on with the job of building shareholder value -- using a little of my capital to do so.

Disclosure: As at 5 November 2009, David Holding held shares in Nautical Petroleum.

Tesco: Pushing for Global Domination

BY MALCOLM WHEATLEY

TESCO

LSE: TSCO
Market: Main
Headquarters: Cheshunt, Herts
www.tescoplc.com

FINANCIAL SNAPSHOT

Recent Price:........................ 419p
Market Cap:..................... £33.2bn
Buy Guidance:.....................468p
(Data as of 05/11/09)

WHAT IT DOES

It's the UK's leading supermarket and is expanding quickly into non-food and overseas markets.

WHY BUY

» Leading UK market position, pushing into telecoms and financial services
» Property-backed balance sheet
» Well-regarded management team
» Clearly laid out international expansion plans

There won't be a reader who doesn't have an opinion about **Tesco** (LSE: TSCO). Love it or loathe it, fight it or fear it, Tesco is the 800lb gorilla of British retailing.

And not just grocery retailing. In addition to the company's 2,282 UK stores -- many of which sell clothing and household items as well -- Tesco also has a catalogue-based online store that sells everything from beds to domestic appliances, and computers to sofas. You can also buy your telephone and broadband service from Tesco, as well as your mobile phone.

Tesco's personal finance arm, formerly operated in partnership with **Royal Bank of Scotland** (LSE: RBS), is now wholly-owned. Re-badged Tesco Bank, the company intends to transform it into a full-service consumer bank, as opposed to its present position as a leading provider of loans, credit cards, savings accounts and insurance services.

And that's before getting into the company's in-store opticians, on-line music download store, home delivery of wine by the case, and on-line bookstore.

Enough. You get the point. There isn't another British retailer quite like Tesco -- not just in terms of its presence in the British retail market, but overseas.

For in addition to its high-profile (and, it has to be said, high-risk) foray into the American retail market, Tesco operates stores in China, the Czech Republic, Hungary, India, Japan, Malaysia, Poland, the Republic of Ireland, Slovakia, South Korea, Thailand, and Turkey.

Some 38% of the company's 468,000 employees work overseas, rather than in the UK. And some 75% of the eight million square feet of new space that the company is planning to add this year is outside the UK.

ABOUT THE COMPANY

Famously, Tesco's history goes back to 1919, when founder Jack Cohen began to sell surplus groceries from a stall in the East End of London. The first store opened ten years later in Edgware; the company listed on the Stock Exchange in 1947; and the first Tesco self-service supermarket opened in 1956.

The 1960s and 1970s were a period of rapid growth, both organically and through acquisition. Sales first topped £1bn in 1979, and broke through the £2bn barrier in 1982.

Tesco's low-cost 'Value' brand was launched in 1993; overseas expansion began in 1995 with a presence in Hungary (Poland, the Czech Republic and Slovakia followed a year later); and Tesco Personal Finance was founded in 1997.

2000 onwards has seen more overseas expansion -- notably Malaysia in 2002, Turkey and Japan in 2003, China in 2004 and America in 2007 -- and the growth of Tesco's on-line presence. Tesco.com began in 2000; music download sales began in 2004, and Tesco Direct launched in 2006.

Profits topped £2bn for the first time in 2005. According to the company's latest half-yearly results, on-line sales now exceed £1bn a year.

INVESTMENT THESIS

The investment logic for Tesco is simply stated. It's a diversified high-quality company with a strong property-backed balance sheet, good management, a history of delivering growth, and with solid defensive credentials.

I would argue it's also cheap. While the FTSE has climbed 46% from its 12 March 2009 low of 3,512 to close at 5,126 on 5 November, for instance, Tesco's recovery has trailed the market. Changing hands at 310 pence on 12 March 2009, the company's shares closed at 419 pence on 5 November, a rise of just 35%.

In late summer, the lagging recovery was even more striking. On 27 August, when the FTSE was only a shade down from 5 November levels at 4,869, I picked up a tranche of shares at 370 pence.

Tesco is also cheap when compared to its competitors, being priced at a multiple that likely discounts a good chunk of future growth. Take a look:

Company	Forward P/E
Tesco	14.3
J. Sainsbury (LSE: SBRY)	15.2
Wm. Morrison (LSE: MRW)	14.2
Marks & Spencer (LSE: MKS)	13.2

Source: Digital Look

Let's see. Does Morrison's have a banking operation and hefty on-line and overseas presences to bolster its future revenues and earnings? Its near-identical P/E suggests it does. How about Sainsbury's? It's got a banking arm, to be sure, but not the same overseas presence or on-line footfall -- despite which it's actually rated more highly than Tesco, at a P/E of 15.2.

And what of Marks & Spencer? It, too, has a finance arm, but has only recently announced a return to overseas retailing after pulling out in the 1990s. Its P/E is lower than Tesco's, but by a relatively narrow margin.

Why so cheap, then? There are several things going on. To begin with, Tesco's major UK competitors -- those companies listed in the table -- have all been going through a re-rating having recovered from difficult trading conditions.

Morrison's 2004 takeover of Safeway didn't go smoothly, leading to a troubled relationship with the City, and the eventual departure of chairman Sir Ken Morrison in 2008. Marks & Spencer had a torrid start to the decade, and under chief executive Sir Stuart Rose has experienced something of a renaissance. Sainsbury's too had a rocky patch, that now seems to be behind it.

More to the point, perhaps, the market is worried that Tesco's own rocky patch may be ahead of it. Certainly, history suggests that a business that strays too far from its core competencies and markets is playing with fire.

Retailing history in particular is littered with examples of botched forays into the American market, or undertaking a brand extension too far. Tesco is actively doing both -- through its Fresh & Easy format in the US, and Tesco Bank here in the UK -- and uncertainty about the eventual outcome is undoubtedly priced into the share. Given the solid track record of Tesco's management over the past quarter century of stellar growth, that's an uncertainty that I'm happy to live with.

Given all this, a forward P/E of 16 times looks like a reasonable buy limit at the moment, which would equate to a share price of 468p.

FINANCIALS AND VALUATION

In its last full year of trading, ending 28 February 2009, Tesco's after tax profits were £2.2bn on sales of £54.3bn, resulting in adjusted earnings per share of 29.1 pence. The company declared a total dividend for the year of 11.96 pence, up from 10.9 pence the previous year. Dividend cover over the past five years has been consistently in the range of 2.3-2.5.

Pundits carp about the company's growth rates declining, but that's a view -- I believe -- that's blinkered by both a UK-centric and grocery-centric view of the company. With a growing proportion of sales coming from emerging economies and Asian tigers, a major slowdown seems unlikely.

Year ending February	2009	2008	2007	2006	2005
Revenues	£54.3bn	£47.3bn	£42.6bn	£39.4bn	£33.9bn
Earnings per share (basic)	27.5p	26.7p	23.6p	20.2p	17.5p
Dividend	11.96p	10.9p	9.64p	8.63p	7.56p

Half-year results for the six months ending 29 August 2009, announced on 6 October, saw pre-tax profits rise 1.5% to £1.4bn from revenues up 9.3% to £27.8bn -- a performance indicative of the tough times the retail sector has been experiencing.

Net debt is high at £9.5bn, having risen sharply in 2008 as a result of buying out Royal Bank of Scotland's share of the Tesco Bank business, as well as acquiring 36 hypermarkets in South Korea.

However, the company said that it remained on-track to achieve a year-end net debt target of £8.5bn, with further reductions planned for the next financial year. This is to be achieved, says Tesco, through keeping capital expenditure below operating cash flow, by releasing working capital through inventory reduction, and by using proceeds from the divestment of property assets.

As net debt reduces, the presently high level of financing costs, running at about £400 million per year, should reduce as well -- freeing up cash for either dividends or further expansion. Historically, Tesco's preference has been for the latter.

Reassuringly, the balance sheet is bolstered by £46bn of assets, of which £23bn is property.

RISKS

Buying into Tesco is making a bet on two factors. The first is management: Tesco is fortunate to have had a series of exceptionally able chief executives, backed by a strong management team. As a result, it has so far avoided the bear traps than so many of its competitors have encountered. That won't always be the case, and the twin forays into banking and America may yet prove to be a case in point.

Secondly, buying into Tesco is placing a bet on the consumer, particularly the UK consumer. Apart from the last two years, the period from 1990 onwards has generally been a good one for consumers, with rising disposal incomes and a growing sense of property wealth fuelling something of a consumer boom. Will the next ten years prove as benign to the consumer -- and by implication, Tesco? We shall see.

WHEN I'D SELL

If the present recession has taught us anything, it is that once-solid dividend payers can abruptly cut or cancel their payouts.

It's difficult to envisage Tesco doing either in the foreseeable future. While not a generous payer, its track record of delivering dividend increases is good. So for income investors, the question is: Why sell?

That said, a P/E of over 20 would doubtless tempt many investors. At present earning levels, that's equivalent to a share price of 585 pence.

FOOLISH BOTTOM LINE

Tesco offers the chance to invest in one of the UK's biggest and most solid businesses, yet one that is growing overseas and on-line, and entering new markets such as banking. Well managed, and with a strong balance sheet, Tesco appears to be overdue for a re-rating.

Disclosure: As of 5 November 2009, Malcolm Wheatley owned shares in Tesco.

Healthcare Locums: Demographics is Destiny

BY PADRAIG O'HANNELLY

HEALTHCARE LOCUMS

LSE: HLO
Market: AIM
Headquarters: London
www.hlcplc.com

FINANCIAL SNAPSHOT

Recent Price:........................ 266p
Market Cap:...................... £278m
Buy Guidance: **340p**
(Data as of 05/11/09)

WHAT IT DOES

Healthcare Locums provides doctors, social workers and allied health professionals to a range of NHS, local authority and private sector clients.

WHY BUY

» Positioned to benefit from secular demographic and social trends.
» Should prove robust regardless of economic conditions.
» Well managed, cash generative, and undervalued.

Recommending a staffing and recruitment company in the middle of a recession may seem a little strange, but bear with me: Staffing companies are not all the same, and I believe I've found an undervalued business with a bright future -- I've even bought shares in it myself.

I first encountered **Healthcare Locums** (LSE: HLO) while searching for companies that might meet the criteria outlined by renowned investor Marty Zweig. While not a disciple of any particular guru, I find it interesting to consider what these people might buy, and Healthcare Locums was one of only three companies on the UK market that looked like contenders based on Zweig's ideas.

ABOUT THE COMPANY

The company was founded by Kate Bleasdale, a former nurse with an impressive record in the health care staffing industry. Having seen first-hand the requirement for skilled professionals in the health sector, she established Match Healthcare in the mid-1980s to fill the gap, and built it into the leading player in the field.

Ms Bleasdale was later forced out of the company she created, and she successfully sued on the grounds of sexual harassment. But in April 2003 she started again, setting up Healthcare Locums, which has gone on to eclipse her original business, and within five years claimed a market-leading position in each of its divisions.

The early years were characterised by a string of acquisitions, including Thames Medics, Eurosite Human Resources, and RS Locums. These brands live on under the Healthcare Locums umbrella, while their back office functions were swiftly integrated.

THE BUSINESS IS NOW PARTITIONED INTO FIVE DIVISIONS:

- Doctors;
- Qualified Social Workers;
- Allied Health Professionals (e.g. pharmacists, radiographers);
- UK Permanent placements; and,
- International Permanent Placements.

For half year to 30 June 2009	Revenue (£m)	Gross Margin
Doctors	26.3	27.0%
Qualified Social Workers	21.6	23.6%
Allied Health Professionals	35.6	34.0%
UK Permanent placements	0.9	100.0%
International Permanent Placements	2.1	71.4%
Total	86.5	30.9%

INVESTMENT THESIS

It's no secret that the world's population is increasing, and as people become more prosperous they live longer and expect a higher quality of health care. Britain's population is expected to rise from just over 61 million at present to 70 million within 20 years.

These are secular trends, and while we can question the accuracy of forecasts, the general direction appears clear. And to borrow a phrase from Keynes, I'd prefer to be roughly right than precisely wrong.

Politics plays a role too. The European Working Time Directive, for example, restricts the number of hours that staff can work, thereby increasing the requirement for headcount, and for flexibility in staffing. Similarly, the need for social workers to study to degree level has reduced the numbers of people entering the profession, contributing to shortages.

In the US, Congress recently passed President Obama's Affordable Healthcare for America bill, which will bring health cover to an additional 48 million people. The bill still has to get through the Senate, but even without this initiative they already needed an additional 1.2 million nurses by 2014.

To capitalise on these international opportunities, Healthcare Locums has opened offices in New York, Melbourne, Abu Dhabi and Dubai, and has recently signed an exclusive agreement to train South Korea's health care staff for international placements.

Even cutbacks in health budgets could benefit the company, as the flexibility of temporary staff can be a cost-effective solution to shortages. Ms Bleasdale describes the business as recession-proof.

The company took on debt to finance the initial acquisition phase, but the last of these acquisitions was bolted on in April 2007, and Healthcare Locums' stated aim is to grow organically.

As a result, it is now able to pay down debt and implement a progressive dividend policy. At the end of June debt stood at £21.2m, down from £31.6m a year earlier, and representing a gearing of 32%. Analysts expect the debt to be cleared by the end of 2010.

Dividends are expected to double this year to 4p per share, and double again next year to 8p, which would equate to a dividend yield of 3% on the current price of 266p.

These dividends will doubtless be welcomed by Ms Bleasdale, as she retains 9.6% of the company's shares. She and other directors also made significant purchases at the mid-90p level in October 2008. I like to see the boss having a substantial stake in the business, as it aligns her interests with those of the shareholders.

Investors often debate whether it's important to meet with management: On one hand, it's good to satisfy oneself that they're up to the job, while on the other hand the management of a quoted company will almost always exude credibility, regardless of the reality.

I haven't met Kate Bleasdale, but I have spoken with her on the phone, and for what it's worth I found her to be frank, straightforward, knowledgeable and determined. To the extent that one can tell from a telephone conversation, she is exactly the sort of person you'd want to have running your business.

More objectively, we can look to her track record of creating both of the top two health care staffing companies, and to her demonstrated personal resilience. She has won several awards for entrepreneurship.

The management runs a lean operation, with many back office functions outsourced to India. It is also clear on its strategy and strengths, avoiding the nursing market in Britain, for example, as this would require an extensive branch network.

The shares having soared in price over the past year, my initial fear was that I had missed the boat. But the real question should be 'is the company worth buying at the current price', rather than worrying about historical prices, and I address the question of valuation below.

But the historical price is still relevant in that it can show whether the company is being ignored by the market. Investors like Jim Slater and Marty Zweig like to find shares that have already out-performed the market, as Healthcare Locums has done, as it shows that they already have the wind of positive investor sentiment behind them, in contrast to other 'value' companies that may remain unloved for years.

A quick look at the books shows that there are no pension problems, as pensions are of the defined contribution type. Options issued are less than 5% of issued share capital, so will not cause any significant dilution of shareholdings. And as acquisitions are off the agenda, the accounts and growth comparisons should be fairly straightforward.

FINANCIALS AND VALUATION

All of this would mean little if the shares were excessively priced. But at 266p, they trade on a price/earnings (PE) multiple of 12.4 times 2009 earnings, and 10.2 times next year's. With growth next year forecasted at 22%, giving us a PEG factor of 0.56, this just seems too cheap.

Historic	2005	2006	2007	2008
Turnover (£m)	43.9	64.6	135	166
Normalised EPS (p)	4.0	7.2	9.1	11.8
Growth year-on-year	-	79.1%	26.5%	29.5%
Dividend per share (p)	-	-	1	2

Forecasts	2009	2010
Normalised EPS (p)	21.4	26.1
Growth year-on-year	81.4%	22.0%
Dividend per share (p)	4	8

I can appreciate that uncertainty over health care budgets (see below) means that a discount to the market is justified, but at present I would happily pay 13 times next year's expected earnings, 340p.

If these concerns are shown to be unfounded, and only time will tell if this is the case, then such a cash-generative and robust business should deserve a premium to the market, and applying that premium multiple to a future year's earnings would push the price target up even further.

A 3% expected dividend next year is quite chunky for a growing company. Cash flow exceeded profits last year and in the first half of this year, and covered the interim dividend 7.2 times.

RISKS AND WHEN I'D SELL

Long term, I don't think anyone would dispute the trends in population size, longevity, and the demand for improved health care. But short term there is clearly a danger that the business is not as recession-proof as has been suggested.

Despite being dependent on the NHS for around 40% of sales, the company is confident of maintaining margins, as its services save clients money due to their flexibility. I'd consider selling if this appeared not to be the case, and I think it's advisable to watch this closely.

But I would not sell on news of cuts in NHS budgets; I think such cuts are highly probable, and the investment case is based on these cuts not harming the business. Any price falls as a result of such headlines, and in the absence of any evidence of weakness in the business, I'd regard as an opportunity to average down.

There is also currency risk as the business expands abroad, but this is just as likely to be an opportunity, so on balance I'm relaxed about it. I'm also relaxed about any possibility of stricter regulations regarding the two-year working holiday visas on which many doctors work, as no government would want to choke off the supply of talent.

I would be quick to sell if Ms Bleasdale were to leave the company, unless a departure was planned far in advance. Nobody is indispensable, of course, but she appears to be the driving force behind the business, and that's part of what investors are buying into. At the age of 48, and with the outlook more exciting than ever, I'm not expecting her to retire.

FOOLISH BOTTOM LINE

I view Healthcare Locums as an undervalued, cash-generative business in a growing industry. I expect its robustness to be tested, but I am confident that it will continue to thrive.

Disclosure: As of 5 November 2009, Padraig O'Hannelly owned shares in Healthcare Locums.

Charlemagne Capital: Ready to re-conquer

BY OWAIN BENNALLACK

CHARLEMAGNE CAPITAL

LSE: CCAP
Market: AIM
Headquarters: Cayman Islands
www.charlemagnecapital.com

FINANCIAL SNAPSHOT

Recent Price:.......................17.75p
Market Cap:.......................£49.8m
Buy Guidance: **20p**
(Data as of 05/11/09)

WHAT IT DOES

Multi-faceted asset manager specialising in emerging markets.

WHY BUY

» Very experienced founder/CEO with significant personal shareholding
» Proven ability to wring large profits from rising assets under management
» Potential to buy in at low point in cycle
» Balance sheet backed by £13m in net cash

What a difference a crash makes. Earlier this decade London-based asset manager **Charlemagne Capital** (LSE: CCAP) could do no wrong, culminating in a 2006 flotation that valued it at nearly £300m.

Today Charlemagne is worth a sixth as much, after plunging stock markets and investors withdrawing their money slashed assets under management (AuM), and Charlemagne's earnings from management and performance fees.

Yet for bullish investors, this could be an opportunity. While Charlemagne's earnings will likely remain depressed in the short term, AuM are growing again, and investors are arguably even hungrier for emerging markets than before the crash. There are risks to investing, but I believe Charlemagne has the proven skills and product range to prosper if the emerging market recovery holds.

ABOUT THE COMPANY

Charlemagne Capital's roots lie in an asset manager called Regent Pacific Group, which was founded in 1990 by among others entrepreneur Jim Mellon and Jayne Sutcliffe. Sutcliffe's division -- focussed on Eastern Europe and Russia -- was spun-off in 2000 to create Charlemagne.

Mellon was chairman and Sutcliffe CEO. In 2006 they floated the company on AIM, achieving a valuation of £298m. According to The Guardian (9 September 2007) that made Sutcliffe the City's second-richest woman. She remains CEO today. Mellon -- still the largest shareholder -- is now a non-executive director.

Charlemagne Capital is now valued at just £50m, and Sutcliffe's diminished shareholding has fallen in value to £5.5m.

The point of this history lesson is that while the past 18 months have been torrid (as we'll discuss below) Charlemagne's record -- and that of Jayne Sutcliffe -- stretches back far beyond the flotation and recent market difficulties. This is a company with entrepreneurial roots that has grown rapidly before, and I believe it could again.

THE 2008/9 ANNUAL REPORT DISTINGUISHES FIVE AREAS OF BUSINESS:

- Magna -- Long funds, covering various emerging market regions
- OCCO -- Emerging market hedge funds
- Specialist funds -- Various theme-based investment vehicles
- Institutional (White Label) -- Retail fund management contracts with third-party institutions
- Institutional (Mandates) -- Funds run for institutions

The proportion of business associated with each area has waxed and waned -- a couple of years ago there was a queue of money to go into the company's hedge funds, whereas more recently Charlemagne has seen massive net outflows from OCCO.

The business areas also differ in terms of margins and the volatily of their contribution to earnings.

INVESTMENT THESIS

Key to Charlemagne's profits is its AuM. All figures in US$:

Year ended 31 December	2004	2005	2006	2007	2008
AuM at year end (unaudited)	2.2bn	4.1bn	4.7bn	6.5bn	2.2bn
Management fees	14.5m	27.3m	38.6m	43.5m	39.5m
Performance fees*	30.9m	63.6m	52.6m	90.4m	4.2m
Operating profits*	24.0m	49.6m	46.9m	70.8m	16.6m
Earnings per share	2.7c	9.7c	12.6c	20.5c	4.9c

*Source: Annual Report for year ended 31 December 2008. * excluding non-recurring items*

Management and performance fees clearly soared as AuM boomed, boosting bottom-line earnings. Equally, the precipitous drop in AuM from $6.5bn at the end of 2007 to just $2.18bn in 2008 crushed the company's profits.

Today, Charlemagne Capital's AuM are growing again. The half-yearly report put AuM at $2.4bn, up 28% from the nadir in March 2009 and 9% higher than at the start of 2009. AuM hit $2.9bn by 2 November.

Unlike some fund managers, especially those operating hedge funds, Charlemagne has seemingly withstood the worst crash in a generation with its structure intact, cash on its balance sheet, and AuM growing again.

This is a risky play, but if the company can repeat its performance in the last cycle, I believe the share price could follow growing earnings to reach a price far higher than today.

FINANCIALS AND VALUATION

I don't think fund management is rocket science -- in good times, decent managers do well, and in bad times earnings crumble, with the weakest companies failing.

Charlemagne's particular product mix caused AuM to fall further than some other listed emerging market managers, such as **Ashmore** (LSE: ASHM) and **City of London Investment Group** (LSE: CLIG). But it could mean Charlemagne recovers quicker, too.

Fund management is a geared business in that extra funds do not require much extra resource to manage them. While a performance-driven manager like Charlemagne loses revenue when its funds lose money, the silver lining is expenses (specifically bonuses) also drop.

The following table, which compares earnings in the first six months of 2009 to the same period in 2008, shows this:

	6 mths to 30 Jun 09 US$m	6 mths to 30 Jun 08 US$m	Year to 31 Dec 08 US$m
Revenue	9.5	30.3	43.7
Personnel expenses	(5.7)	(14.1)	(20.9)
Other costs	(2.5)	(3.0)	(6.1)
Profit before tax	1.3	13.2	16.6
Earnings per share	0.4c	3.9c	4.9c

Source: Half yearly report 2009/10

Also note how profits plunged in 2008 and 2009 compared to the boom year of 2007, when Charlemagne made over 20 cents a share and paid 6p per share in special dividends.

In contrast it has made just 0.41 cents per share in the first half of 2009. But by luck or judgement, the company had no debts to threaten its solvency, and it remained profitable even as AuM troughed.

Assuming the global market rally holds, future earnings should now grow as AuM rise and performance fees return, albeit with some lag.

Writing in November, it seems safe to roughly double up the half-yearly earnings to 0.8 cents per share for 2009. At £1:$1.67, that's 0.47p per share.

However given that markets and AuM have continued to recover since June, that may prove too pessimistic. Analysts at Singer Capital Markets in a forecast on 3 November were looking for 0.6p per share; Evolution Securities forecasts 0.49p (2 November).

Taking the consensus of 0.56p for 2009, the shares are on an estimated P/E of 31 -- hardly cheap!

But let's assume AuM grow to over $4 billion in the future, as they did between 2004 and 2005. That produced earnings of 9.7 cents per share, or 5.8p.

Charlemagne's management warns that margins have fallen in the turmoil, dropping from 82 basis points in 2008 to 74 basis points now, which it said in the half-yearly report was sustainable going forward.

Reflecting this, let's knock estimated earnings per share on $4 billion down to 5p. Such earnings -- should they materialise -- would put Charlemagne on a P/E ratio of just 3.5!

Will this happen? The consensus forecast for 2010 is for only 0.9p per share, or a P/E of just over 19. Analysts will have had to guess an AuM figure to base their predictions on; in my view, 'guess' is exactly the right word.

The point is if Charlemagne can grow AuM again -- whenever it happens -- the geared effect on operating profits should provide bumper earnings for shareholders and a sharply higher share price.

At a mid-cycle P/E of say 8 to 10, earnings of 5p would translate to a share price of 40p to 50p -- more than doubling today's price, from a less than 50% rise in AuM.

There's no way to tell when this might happen, but the promising recovery in AuM in 2009 and past history shows it's possible for AuM to mushroom in just a year or two.

For this reason, I'm a buyer up to 20p.

RISKS

I feel the biggest risk is the resumption of bear market conditions. Any recovery in earnings is completely dependent on AuM increasing.

The unpredictability of stock markets means Charlemagne should therefore only be a relatively modest investment, however confident you are of its management and operations.

What if Charlemagne proves unable to grow AuM significantly, even in benign conditions? This might happen if the reputation of boutique fund managers -- particularly those associated with hedge funds and riskier markets -- fails to recover from recent history and issues such as the Madoff affair. Charlemagne admitted in its latest half-yearly report that nervousness caused by the latter had prompted some withdrawals.

The danger here is that Charlemagne is unable to cover its costs. According to the most recent half-year report, cash and cash equivalents fell from $28.1m to $21.8m over the past six months.

Investors must trust that management's confidence in the future earnings of Charlemagne is well-founded. If AuM and earnings did fall again, they could suspend the dividend.

An annoying titbit revealed in the half yearly report is the granting of over 13m options to employees in March 2009 with a weighted average exercise price of 9p. My problem here is that's barely above the share price low of 7.25p. Still, there are (undisclosed) vesting conditions linked to AuM performance targets, and a requirement for three years service, which at least should keep staff on-board for a while.

On a related note, it's difficult to tell if Charlemagne has been hit by disillusioned staff leaving during the downturn. I suppose there must also be a danger that Sutcliffe and other insiders have lost the appetite for growing the company post-flotation, though personally I think that risk is small -- my perception is successful City types never lose that hunger!

It's worth noting founder Jim Mellon added modestly to his shareholding on 5 October; he now owns 19.8% of shares. I see the purchase as a bullish sign, but I suppose there may be some risk of an attempt to take the company private again at a bargain price.

Finally, bear in mind that this company reports its results in US dollars, so there is foreign currency risk to consider as well. The performance of the pound against the dollar may affect any investment return.

WHEN I'D SELL

Charlemagne's shares aren't cheaply rated compared to its near-term earnings -- there are barely any earnings, and we saw the forecast P/E is 31. Nor have AuM mushroomed yet -- they are still around two-thirds below the peak.

Rather, I feel this will be an unfolding story, with AuM and earnings increasing in step, and the P/E eventually falling to a more reasonable mid-cycle rating.

It seems to me there are two risky periods in holding the shares -- when AuM are falling, such as most of last year, threatening the solvency of the company, and also when AuM are high and peaking and the market is ignoring the risk of another crash.

To invest now is to believe the danger of the first risk has passed. The second risky period will likely come after a few years of solid emerging market growth, when investors and even fund managers have forgotten all about bear markets.

Because this future is unknowable, I don't see any particular reason to sell when earnings per share or AuM hit some fraction or multiple of their previous peak, say. Rather, I'll look out for excessive optimism around emerging market investments -- unprecedented inflows of cash, or indices trading at high P/E ratings.

At that point, where the upside would likely be limited and the downside precipitous, I'd reduce my holding in Charlemagne.

FOOLISH BOTTOM LINE

In his 1940s book on Wall Street, Where are the Customers' Yachts?, Fred Schwed summed up in his title the eternal question for investors. Are fund managers in it for them, or themselves?

Buying Charlemagne Capital is an opportunity to align your bets with a fund manager as much as with its products.

Charlemagne is certainly very vulnerable to a fresh setback in the wider markets, but as a bull on global stock markets and a believer in the long-term appeal of equities, I think there's a better chance of recovery if and when the company regains its former glory.

GlaxoSmithKline: A Great Global Stock

BY MALCOLM WHEATLEY

GLAXOSMITHKLINE

LSE: GSK
Market: Main
Headquarters: Brentford, Middlesex
www.gsk.com

FINANCIAL SNAPSHOT

Recent Price:....................1,220p
Market Cap:.....................£63.3bn
Buy Guidance:...................1,400p
(Data as of 05/11/09)

WHAT IT DOES

One of the world's leading drug research companies.

WHY BUY

- Leading global drugs and consumer brands
- Focusing on emerging markets
- Near 5% dividend yield, twice covered by cash flow
- Low volatility of earnings

GlaxoSmithKline (LSE: GSK) is the world's second largest pharmaceutical company. Headquartered in Brentford, it was formed in 2000 with the merger of Glaxo Wellcome and SmithKline Beecham -- businesses with roots going back to 1880 and 1843 respectively.

The company employs around 99,000 people in over 100 countries, and manufactures almost four billion packs of medicines and healthcare products every year. Every minute, apparently, over 1,100 prescriptions are written for GlaxoSmithKline pharmaceutical products.

ABOUT THE COMPANY

But unless you're unfortunate enough to require such a prescription, GlaxoSmithKline's leading drugs -- and sources of revenues and profits -- may not be familiar to you. Names like Cervarix, the company's cervical cancer vaccine, Wellbutrin, an anti-depressant, ulcer treatment Zantac and anti-swine flu vaccine Relenza are reasonably well-known, however.

Just as importantly, GlaxoSmithKline is also a consumer business with a robust collection of strong brands: Ribena, Horlicks, Lucozade, Aquafresh, Sensodyne, Panadol, Tums, Zovirax -- and of course, the Macleans range of toothpaste, mouthwash and toothbrushes.

Every day, according to GlaxoSmithKline's website, more than 200 million people around the world use a GlaxoSmithKline-branded toothbrush or toothpaste, while every year the company's factory's churn out produce nine billion Tums tablets, six billion Panadol tablets, and 600 million tubes of toothpaste.

Under chief executive Andrew Witty, who succeeded Jean-Pierre Garnier in May 2008, GlaxoSmithKline has changed tack in a number of important respects -- including a restructuring programme aimed at delivering £1.7bn in annual savings.

What's more, Witty has moved the company away from a strong Western focus -- in particular, the American market -- towards emerging markets.

"The dynamics of GSK's business are changing," said Witty in the Q3 2009 results released on 28 October. "We are seeing direct evidence of success in our strategy to grow and diversify the business away from a dependency on 'white pill/western markets'. Less than 30% of this quarter's sales were generated from these products and markets compared to 38% in the second quarter of 2008. Sales in emerging markets now represent 14% of pharmaceutical turnover compared to 12% this time last year."

INVESTMENT THESIS

From an investor's point of view, GlaxoSmithKline has two key attractions. First, it has underperformed the market in this year's rally. From 3 March 2009, when the FTSE 100 bottomed at 3,512, the company's shares had climbed 21% by 5 November. But the FTSE 100 itself, meanwhile, had soared 46% -- over twice as much.

And at 1,220 pence, their level of 5 November, that's a P/E ratio of just 12.3. Which is distinct value territory for a blue-chip world-class pharmaceutical business. It has global sales of £24.3bn, generates post-tax profits of £4.7bn and throwing off quarterly dividends totalling 57 pence last year, which were covered 1.8 times by profits.

Legendary fund manager Neil Woodford has made the same call. In early October, he revealed that he'd been selling his massive holdings in **BP** (LSE: BP) and **Shell** (LSE: RDSB), and putting the freed-up cash into pharmaceutical businesses -- specifically, GlaxoSmithKline and **AstraZeneca** (LSE: AZN).

His logic? "When I switched out of BP to GlaxoSmithKline," he explained in an interview with the Citywire website, "I could do so on the same yield from a company that was not covering its dividend, to one that covered it two times over with cashflow."

And better still -- as I've already remarked -- GlaxoSmithKline looks cheap. "These companies are rated now in a way that ascribes no growth going forward," added Woodford. "But they are extremely cash generative with a low volatility of returns. They are the cheapest assets in the stock market right now. I see them as financial assets, not just drug companies, and as such they are incredibly cheap."

Secondly, GlaxoSmithKline's attraction to investors comes from a decision taken by incoming chief executive Andrew Witty to resolve the consumer products issue. For years, this part of the business has been something of a poor relation, seen as dull and boring. Analysts and activists have urged the company to either break it up, or sell it wholesale, perhaps via a flotation.

Witty is doing neither: consumer products are core to GlaxoSmithKline's business, he has decided, and offer a useful element of diversification to set against the company's dependence on pharmaceutical sales. It's a stance I very much like. Pure pharmaceutical companies are always at the mercy of their product development pipeline, forced to squeeze as many sales as they can from of an expensively-developed new drug before it goes 'off patent', and generic copies come onto the market.

FINANCIALS AND VALUATION

Which brings us back to the share price, and cheapness. While GlaxoSmithKline's P/E ratio is mired at 12.3, two other UK-based companies with strong global consumer brands in comparable markets do rather better.

Unilever (LSE: ULVR) and **Reckitt Benckiser** (LSE: RB), for instance, both trade on prospective P/Es in the region of 16. If GlaxoSmithKline enjoyed a similar rating, the company's shares would be valued at around 1,600 pence, some 30% higher than their value on 5 November. I'd certainly be comfortable buying up to halfway between the current price and this level, say 1,400 pence.

The company's Q3 2009 results spoke encouragingly of 'a return to sales growth', with continued improvement is expected in Q4. This is necessary, because any higher rating imply growing earnings and growing shareholder returns -- and GlaxoSmithKline's progressive dividend policy, don't forget, needs growing sales and profits to be sustainable.

How likely is that re-rating? Well, recall Neil Woodford's observation about GlaxoSmithKline being rated "in a way that ascribes no growth going forward." And certainly, growth hasn't been a feature of GlaxoSmithKline's results in recent years, as we see in the table below.

	2008	2007	2006	2005	2004
Revenues	£24.3 bn	£22.7 bn	£23.2 bn	£21.7bn	£20.0 bn
Post-tax profit	£4.7 bn	£5.3 bn	£5.5 bn	£4.8bn	£4.0 bn
Dividend	57.0p	53.0p	48.0p	44.0p	42.0p

But that lack of growth could be about to change: the company's new post-Witty set of 'strategic priorities' is finally intended to deliver growth, with Q3 and Q4 2009 being pointed to as signals that the strategy is working.

And what are these priorities? According to the company, they are 'to grow a diversified global business, deliver more products of value, and build a simpler operating model.'

RISKS

Ambitious stuff. But will GlaxoSmithKline succeed in achieving these ambitions? Failure has to be one of the biggest risks to investors, locking them in to a growth story that fails to take off.

And indeed, I'm more concerned about that failure than I am about the more usually-cited risk of GlaxoSmithKline failing to churn out enough new wonder drugs and cures to replace mature products going 'off patent'. For the challenge faced in delivering those priorities is very real: Witty is young (mid-40s), while GlaxoSmithKline itself is very large with the usual 'big company' mindset and failings.

In short, unless the board does manage to convince investors that its collections of consumer brands and top-notch drugs can deliver growing earnings, the P/E ratio and share price is doomed to remain where it is. So the next few quarters could be critical in terms of providing a clue as to the outcome.

WHEN I'D SELL

I bought my holdings in GlaxoSmithKline in 2007 and 2008, seeing it as a solid dividend payer with a progressive dividend policy and hoped-for growth prospects. While I've been disappointed with the growth side of things, the dividends have held up (and increased) very nicely.

But my investment logic remains the same: dividends and growth. If either was under lasting threat, I'd sell. But I wouldn't sell otherwise, unless the P/E reached stratospheric levels: as one of the world's leading pharmaceutical companies, with a global reach, GlaxoSmithKline is a stock for the long term.

FOOLISH BOTTOM LINE

And that, in essence is the Foolish bottom line. GlaxoSmithKline is a great global company -- with the added advantage of looking cheap, and with a reasonable chance of decent long-term growth.

Disclosure: As of 5 November 2009, Malcolm Wheatley owned shares in GlaxoSmithKline.

Telecom Plus: Taking on the Big Energy Players

BY ALAN OSCROFT

TELECOM PLUS

LSE: TEP
Market: Main
Headquarters: London
www.utilitywarehouse.co.uk

FINANCIAL SNAPSHOT

Recent Price:.......................297.5p
Market Cap:...................... £203m
Buy Guidance:.....................**350p**
(Data as of 05/11/09)

WHAT IT DOES

Telecom Plus, trading as The Utility Warehouse, supplies homes and businesses with fixed line and mobile telephony, broadband, gas and electricity.

WHY BUY

- » Strong, growing, debt-free business, making consistent profits and paying rising dividends
- » Unique customer-led marketing, which leads to low costs
- » Top quality management with a proven track record

With today's telecoms and utilities behemoths struggling with debts, costs, and long-term liabilities, it's nice that there is one investor-focused company in these sectors, albeit a relatively small one, that is sticking to the good old-fashioned business practices of striving for low operating costs, organic growth, no debt, and a steadily rising dividend.

That company is **Telecom Plus** (LSE: TEP), and in the 5 years from 2004, it has grown its annual revenues from £81.8m to £278.3m, while at the same time increasing its dividend from 10p per share to 17.5p.

ABOUT THE COMPANY

Telecom Plus was founded in 1996, and launched its first product, a smart call-routing device, the following year. This little box sat between your phone and your phone socket, and routed your calls via the cheapest provider on a call-by-call basis.

The company has expanded its services and now offers, to both domestic and small and medium-sized business customers, full landline and mobile telephony services, broadband, gas and electricity. All commodities are bought in, with energy coming from nPower, and telecoms services from the wholesale market. All services are covered by a single bill.

What is unique about Telecom Plus is its marketing plan. Trading as the Utility Warehouse, the company has no shops and does not spend a penny on TV and mainstream media advertising. Instead, it operates a multi-level marketing model, in which existing customers spread the word to potential new customers, and take a small slice off the bills of anyone they manage to convert -- they act as "Distributors", in the company's parlance.

The Utility Warehouse also operates a Discount Club, offering things like free UK calls, discounts on gas and electricity, together with free telephone support and even some free insurance. Membership of the Discount Club starts at £1.50 a month.

In September 2009, The Utility Warehouse was named as the UK's "Best Energy Supplier" by Which? magazine for the third year in a row, and its Broadband service was given a "Best Buy" award.

INVESTMENT THESIS

Although it's a small fish in its pond, Telecom Plus does not suffer from any of the problems usually associated with smaller, growing, companies. It has been in profit for quite a few years now, and has a good track record of increasing its customer numbers, turnover, profits, and earnings. And, rare for a small company fighting against the big players, it pays a very good dividend.

Growing companies are often financed by debt, and so take longer to start to enrich their shareholders. But Telecom Plus has zero debt. In fact, it has no long-term liabilities at all, and is cash rich, and has been in that enviable position since at least 2004. As at 31 March 2009, its net cash position stood at £25m.

The quality of a management team and its alignment with shareholders' interests is vital. So what I like to see is the directors being paid modest salaries, and having large (but not too large) holdings in my companies. I don't begrudge them the handsome rewards that should rightfully come from excellent performance, but I prefer to see them tightly aligned with shareholders' profits.

On that score, Telecom Plus gets a big tick. The 2009 report states that "The Company's remuneration policy is based on the principle that the fortunes of the directors and senior management are aligned with those of the shareholders".

The Chief Executive, the Hon Charles Wigoder, received total remuneration of a modest £217,000 for the year ending 2009, but that is dwarfed by his dividend entitlement, as he owns approximately 20% of the company's shares -- so clearly, his interests are very closely aligned with ours.

Of the other directors (excluding the outgoing finance director, Richard Hately), the highest paid in 2009 was the new Chief Operating Officer, Andrew Lindsay, on a mere £71,000 (though as he has been only recently appointed to the board, that will increase significantly next year), and all are incentivized by substantial share option allocations.

Also, Telecom Plus has a non-executive chairman in place, in the person of Peter Nutting, together with an additional three non-executive directors, all of whom receive very modest payments. So, all told, what we see is a very shareholder-focused board.

I also feel good about Mr Wigoder's past appointments. With a strong background in the industry, prior to joining Telecom Plus, he set up The Peoples Phone Company plc in 1988, which he grew to an enterprise of 400,000 customers before selling out to **Vodafone** (LSE: VOD) in 1996.

FINANCIALS AND VALUATION

The Telecom Plus financial picture for the last five years, together with consensus brokers' forecasts for the next two year, is as follows:

Year ending 31 March	Turnover £m	Pre-tax profit £m	Basic EPS p	Dividend p
2005	102	10.1	22	11
2006	136	(1.6)	(2.1)	1
2007	176	11.6	12.5	8
2008	186	16.8	17.7	14
2009	278	22.5	24.2	17.5
2010 (f)	309	18.1	18.8	22
2011 (f)	547	25.3	26.9	24.5

Source: Annual reports and Digital Look

Over the five years from 2004 to 2009, the customer base has grown from around 200,000 to 280,000. Although that growth seems relatively modest, the typical number of services taken by each customer has risen over this period. Whereas there were around 300,000 services supplied in 2004, by 2009 this figure had increased to 800,000.

A trading update issued at the end of September revealed a highly impressive growth for the latest six-month period. Customer numbers increased to 316,000 while total accounts have now exceeded 900,000.

The 2006 year shows quite a blip, which the company put down to one-off costs associated with the negotiation of its gas and electricity supply deal with nPower, following extreme volatility and record prices in the wholesale energy markets. Apart from that, it's been a solid performance.

Telecom Plus manages its entire business, including its call centres, with a staff of 450 based in North London -- based on the March 2009 annual report, that indicates a turnover per employee of nearly £620,000.

Current forecasts put the shares on a prospective P/E of 16 for 2010, falling to 11 in 2011. In these days when investors seem to expect all shares to be selling for rock-bottom prices, Telecom Plus is not a bargain-basement company. But then, telecom giant **BT Group** (LSE: BT-A) is on a prospective P/E of 11 and 10 for the next two years, despite having considerable debt and the ever-growing pension deficit millstone around its neck.

With prospective dividend yields for the next two years of 7.3% and 8.2% respectively, the current share price looks way too cheap for me. In fact, as we are past the half-way stage, I think anything better than around 6% is good value, so I'd suggest the shares are a buy up to 350p.

RISKS

I'm usually wary of small telecoms companies, for two reasons. Firstly, it is very difficult to compete with the market leaders in the long term and I usually tend to expect telecoms tiddlers to last a few years and disappear, either to go out of business or be swallowed up cheaply by bigger fish when things start to get a bit rocky.

But Telecom Plus has been competing very well against the big fish, like BT and **United Utilities** (LSE: UU), and has been delivering value-for-money deals to its customers in a highly profitable manner. And it should have enough cash to see out any short-term downturn that might leave smaller fish high and dry (as indeed it did in 2006).

My other fear is that small companies sometimes get their loyalties wrong, and operate with the apparent aim of enriching their managers at the expense of shareholders. But on that count too, I think Telecom Plus passes muster.

As we have seen, the board's remuneration is modest, and with directors holding nearly 30% of the company, their interests should be in line with those of small investors.

With institutional investors holding around another 30%, that should provide enough shareholder muscle while still leaving a good amount of liquidity in the remaining 40%.

The biggest risk, I think, will come if the likes of BT, Vodafone and United Utilities get their debts down, exercise the efficiencies of scale that such giants are supposed to wield, and squeeze the industry's margins though competitive pressure. But none of them looks like achieving that in any foreseeable timescale.

WHEN I'D SELL

A key event in the life of Telecom Plus is going to come when the rate of growth in its customer numbers starts to slow down, and I can see at least two possible scenarios.

One is that the company will be content to carry on serving its customer base, maintaining its profit levels, and paying out its dividends. As long as the prospective dividend yield remains high relative to anything out there at a similar risk (which I think would be around the 5% level at the moment), I'd hold.

The second possible scenario is that Telecom Plus will sell out to a larger telecoms company, as Mr Wigoder's previous venture, The People's Phone Company did. If that happened with Telecom Plus, I'd be happy to sell, because I feel confident that it would only happen at an attractive price. And if it was a paper deal, I'd probably sell the shares in the new company immediately, as I think it's unlikely that I'd want to hold shares in a major telecoms firm.

If the company were to pursue any other strategy (taking on debt to go on the acquisition trail, for example), that would also be time to sell.

FOOLISH BOTTOM LINE

I need to try to be cautious here, because I really don't see much wrong with this company, and I always feel uncomfortable when I can find few faults with an investment.

But the bottom line for me is that Telecom Plus is a small and growing company, which has been profitable for some years now, is growing its profits, cashflow, and dividends, and has not a penny of debt. It is competing nicely with the big fish in its pond, steadily nibbling away at their market share, and appears to have one of the best management teams in the business.

Disclosure: As of 5 November 2009, Alan owned shares in Telecom Plus.

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or alternatively you can call us on **020 7025 8394**

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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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