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Beaufort Securities Breakfast Alert: MySQUAR Limited, Strat Aero, HSS Hire Group, Marston's PLC, Pets at Home

- **MySQUAR Limited (LON:MYSQ)**
- **Strat Aero (LON:AERO)**
- **HSS Hire Group (LON:HSS)**
- **Marston's (LON:MARS)**
- **Pets at Home (LON:PETS)**

"With US markets closed yesterday for Thanksgiving and in the absence of significant overnight news, Europe is expected to have a quiet opening this morning with the FTSE-100 seen just 5 points either side of unchanged in early trading. Markets across Asia ended fractionally higher with even the Shanghai Composite moving positive after falling sharply in opening trade, as conflicting views of regarding the potential impact of tariffs on Chinese imports proposed during Trump's electoral campaign and optimistic scenarios that China now finds itself ideally placed pick up the TTP baton that will be dropped on his first day in office, circulated. Elsewhere in the region, the Nikkei set the early pace with the Yen hitting an eight-month high against the US$, along with similar weakness against the basket of other major Asian currencies, boosting competitivity for this export-led economy. Japanese consumer prices fell by 0.4% in October, although this eight-consecutive decline was in line with consensus and smaller than the 0.5% reported for September. Given also that the ECB is now thought likely to not only continue its EUR80bn monthly asset purchase but also to extend the program out to September 2017, the continuing ascent of the US$ ahead of the Italian Referendum and run-up to the French presidential election, now has forex traders are suggesting parity could between the two currencies could be achieved early in the New Year. Oil meanwhile remained subdued ahead of the OPEC meeting scheduled for 30th November, while Gold fell back again on dollar strength and reduced Indian buying. UK macro releases due today include the second GDP estimate, the CBI Quarterly Distributive Trades Survey and the Hometrack UK Cities House Price Index. Just a few, mostly smaller UK corporates are also due to report earnings or provide trading updates this morning, including Fastjet (FJET.L), Triad Group (TRD.L), Pennon (PNN.L) and Zambeef Products (ZAM.L). Traders will also remain sensitive to further reports from the Western allies who have been pressing Iran for several months for a firm commitment to proceed with proposed cuts to its enriched uranium stockpiles, for fear that otherwise these sensitive negotiations could be scuppered upon Trump's move to the White House in January."
- Barry Gibb, Research Analyst

Markets

Europe

The FTSE-100 finished yesterday's session 0.17% higher at 6,829.20, whilst the FTSE AIM All-Share index closed 0.41% better-off at 818.48. In continental Europe, the CAC-40 finished 0.29% higher at 4,542.56 whilst the DAX was 0.25% higher at 10,689.26.

Wall Street

US markets were closed yesterday for the Thanksgiving holiday.

Asia

In Asian markets this morning, the Nikkei wavered toward the end of the session, but finished up 0.26 percent, or 47.81

points, at 18,381.22, while the Hang Seng rose 0.56% to stand at 22,736.02.

Oil

In early trade today, WTI crude was down 1.08% to $47.44/bbl and Brent was off 1.08% to $48.47/bbl.

Headlines

Black Friday bonanza ahead of new year price hikes

Black Friday sales this year are likely to top £2bn, say analysts, as shoppers hunt for bargains ahead of an expected rise in prices in 2017. The fall in the value of the pound is forecast to push up the prices of imported goods next year. Black Friday sales last year were about £1.9bn, but retailers are now stretching the one-day shopping extravaganza over several days. Amazon and some supermarkets started their sales up to 10 days ago. By Thursday, the discount retailing site TopCashback reported a 30% increase in spending over last year. While more than £2bn is expected to be spent on Friday alone, the total for the next four days is forecast to rise to more than £4bn once the weekend and Cyber-Monday - an online-only event - are included. But increasingly, Black Friday too is becoming an internet bonanza. According to the online retailing association IMRG, well over half the spend on Black Friday will be done online.

Company news

MySQUAR Limited (LON:MYSQ, 4.00p) - Speculative Buy

MySQUAR, the Myanmar-language social media, entertainment and payments platform Group whose principal activity is to design, develop and commercialise Myanmar-focused internet-based mobile applications, yesterday announced an update in relation to its gaming business. Importantly, it expects a major new game, ChakraNinja, based on Naruto, one of the most successful Japanese manga comic characters, to be complete for testing by 5 December and ready for official release by Mid-December. The Group expects to soft-launch a gaming platform that is initially expected to include 4 or 5 casual games by mid-January and then automatically add new games so that users, who have downloaded the gaming platform, will have all the games in one application. By distributing various games via the same platform, the Group will save considerable marketing expenses, as well as increasing user retention and expected monetisation.

Our view: MySQUAR's gaming business continues to perform well with average daily revenue from the Group's existing titles of USD2,500 - USD3,000 during the month of October and the first 20 days of November. In addition, the Group also intends to release further functionality and add-ons for its existing games in the next couple of weeks which is also expected to add to run rate revenue. Profit margins are also expected to increase, dependent on revenue levels (current gross margins of 44% are expected to improve by at least 5%), having also agreed a new revenue share structure, effective from November 2016, with the key payment service provider MecTel, the state-backed mobile phone operator. Away from gaming, Fastsell, the mobile marketplace app, is now expected to be soft-launched on 5 December, immediately followed by a direct marketing campaign aimed at retailers who want to list their products for sale. This marketing tool is already established in Vietnam and is now targeting Myanmar through a new application which allows sellers to list their products while buyers can use the application to identify potential purchases, negotiate prices and identify geographic locations. Monetisation will come from advertising, subscription and handling fees under a perpetual agreement, for which MySQUAR's share of revenues with the developer will be 60%. This, along with further anticipated portfolio expansion in coming months, all suggests MySQUAR is positioned to more than deliver on its promises. Based on recent progress, MySQUAR has the very real potential to be achieving monthly break-even or better before the end of the current financial year. This is something that is unlikely to have been missed by its numerous and very cash-rich global peer group, who remains determined to continue ensnaring players in virgin territories that have successfully participated in an online user 'landgrab'. In this respect, MySQUAR now appears quite dramatically undervalued; Beaufort has set a price target of 21.0p/share and repeats its Speculative Buy recommendation.

Strat Aero (LON:AERO, 0.40p) - Hold

Strat Aero, an international aerospace company focused on the rapidly emerging Unmanned Aerial Vehicle ('UAV') sector, yesterday provided a corporate update covering activity across its divisions. In it, the Board noted that its Survey & Inspection Services division, Geocurve, continues to trade in line with expectations, having been trading profitably since the commencement of its multi-year Environment Agency contract in September 2016. Being a standalone business unit, management does not expect it to require any additional funding from Strat Aero in the near term. The first courses of Strat Aero's Advanced Unmanned Technical Qualification ('AUTQ') programme are also due to be delivered by its franchisees in Asia and by the Company in the UK by the end of Q4 2016 and early 2017. Meanwhile a review is underway for all of the Group's activities and cost base in the United States is in line with strategy to focus primarily on securing additional contracts for its proprietary Digital Data Management system. In order to plug its funding shortfall, it has executed a £300,000 six-month loan facility with a secured fixed and floating charge with Farina Investments (UK) Ltd at an interest rate of 25% over the six-month term. The short-term loan will be used to provide adequate working capital for the Group through to mid Q1 2017 which will enable management to focus on continuing to grow the business in line with its stated strategy.

Our view: Strat Aero's management is doing all the right things. CEO, Ian McLure, has set about refocussing the Group's jumble of drone-related operations and participations that were thrown together by the Group's previous management. Geocurve, in particular stands out, having secured a contract worth £2.5m earlier in the year which provides a big 'tick in the box' from a sector that has otherwise become crowded-out with 'me too' players. Having recognised the extent of its international opportunity, however, Strat's challenge is now to monetise a quality, value-added offering as drones/drone services migrate from the hobbyist to mainstream commercial. With this in mind, the reality is that ATC regulators globally, including the likes of the US's Federal Aviation Administration and the UK's Civil Aviation Authority, have been running significantly behind with UAV/UAS curve for some years now and, given the relatively low cost of entry and the vehicle's potential to create safety hazard, criminal or terrorist opportunity in national airspace, this has to change. When they do catch up, new legal and operating constraints will likely squeeze out the bulk of the 'mom and pop' entities that have saturated this early stage opportunity, leaving larger, more credible players with comprehensive, regulated offerings, like Strat Aero, to seize the longer-term opportunity. That's the upside vision but, back on earth the Group's management still must continue with the work now underway, including restructuring the numerous different businesses that were thrown together over the past 18 months or so, into a series fully integrated and complementary operations while taking the knife to costs. Having recorded an operating loss of some US$2.4m during H1 FY2016, and having managed to raise only around US$0.5m in August's equity placing, Strat's balance sheet clearly remains under strain even after taking up the Farina loan facility. Once such issues have been resolved, however, shareholders will be able to focus back on the scale of its global opportunity and the Group's early mover advantage. For now, Beaufort retains its 'Hold' recommendation.

HSS Hire Group (HSS.L, 89.25p) - Hold

HSS Hire yesterday provided an update on the performance of the Group for the 40-week period ended 1 October 2016. Highlights included 11% revenue growth, with Services (+67%) and continued key account customer growth, along with 2% revenue growth in Rental and related revenue. Adjusted EBITA rose 6% to £14.6m, while margin improvement continued through year from 4.5% at H1'2016 to 5.7% at 9M'2016. Utilisation remains strong at 50% in core categories and c.75% in specialist categories, with capex of £37.9m through 9M'2016, materially lower than in 9M'2015 (£74.7m). The Group's new National Distribution and Engineering Centre provides the platform to serve the UK market with improved customer proposition. Net debt has increased slightly to £240.4m, reflecting increased exceptional costs, which largely relate to the NDEC implementation, together with the additional rent payment taken in Q1 of this year. The Board noted, however, that given the scale, complexity and investment in the operational change being rolled out across the Group, it has taken the decision to extend the implementation period through to Q1'2017. This will impact on HSS' core Rental and related revenue growth, and reduce the speed at which the Group can optimise its remaining network and reduce operating costs. As a result, management warns that Q4'2016 trading will be at the lower end of its expectations. And, based on FY'2016 in the guided £40m - £45m range capex, expects a small reduction in net debt by the year-end.

Our view: HSS has not yet broken free of its habit of disappointing investors. The shares are quite dramatically down from the 210p price they achieved on Admission back in February 2015. But should the market really have been surprised by yesterday's profit warning which, realistically cannot just be blamed on delays in platform roll-out? Probably not is the answer, given the well-publicised divergence between the national housebuilders themselves (with rising profits, exceptional cashflow and lack of Brexit fall out), and the suppliers of building materials (like SIG, Travis Perkins, etc. who have recently been downgrading expectations. HSS' customers are significantly lumped with the latter, with dependence on home repair, maintenance and improvement ('RMI') rather than new builds for a good proportion of their business. This would explain why services and key accounts (which now include Amey) delivered a good performance but pure rental revenues actually contracted almost 4%. Given that the Board is now steering investors to a figure a little above last year's £20.3m (Beaufort's own 2016E EBITA now stands at £20.7m), this highly leveraged Group (net debt having risen to £240.4m at 9M'2016) still remains uncomfortably expensive, based on a 27.2x 2017E P/E multiple, a 17.4x EV/EBIT and a 0.5% yield. Against this background, the key question might now be what exactly powered the sharp upward spike in the shares earlier this month. Some recovery in RMI is certainly expected and the NDEC implementation looks more than priced in. Could it instead be due to Russell Down, Speedyhire's CEO, who after reporting interims back on 16th November suggested that Toscafund's original proposal of merging the two operations had been rebuffed simply because their timing wasn't right? If the market still considers HSS to be a takeover target, perhaps it should first ask exactly who would be prepared to inherit such a big pile of debt? Beaufort retains its Hold recommendation on HSS Hire shares.

Marston's (MARS.L, 132.20p) - Buy

Marston's, a UK's leading pub operator and independent brewer, yesterday announced preliminary results for the 52 weeks ended 1 October 2016 ('FY2016'). During the period, on a statutory basis, revenue advanced by +7% to £937.3m against the comparable period (FY2015). Due to absence of significant impairment of freehold and leasehold properties saw in previous year, operating profit increased by +44% to £163.9m and pre-tax profit jumped by +158% to £80.8m resulting earnings per share grew by +210% to 12.7p. On an underlying basis, revenue advanced by +7% to £905.8m, operating profit rose +4% to £172.7m while pre-tax profit grew +7% to £98m resulting earnings per share improved by 9% to 14p. Operating cash flow increased +13% to £182.8m and net debt at the period end stood at £1,269m (end-FY2015: £1,245m). Return on capital improved by +0.1% to 10.9%. On the operational front, the Group opened 22 new pubs and bars and 6 lodges. As Beaufort previously highlighted, like-for-like sales for Destination and Premium division improved by +2.3%, while Taverns division saw increase of +2.7%. Marston's CEO, Ralph Findlay commented "We have a high quality pub and beer business which is displaying positive momentum and is consistently outperforming the market. We believe that, despite some continuing market headwinds, our expansion plans for new pub-restaurants, lodges and Revere bars will further enhance our ability to deliver attractive returns". The Group proposed a final dividend of 4.7p per share which will be paid on 30 January 2017, bringing full year dividend to 7.3p per share, up +4.3%.

Our view: Marston's reported a good full year performance, having delivered LFL sales and profit growth across all divisions. As noted previously, the Group operating margin declined by -0.5% to 19.1% due to lower margins in Brewing, reflecting the pub supply arrangement with Thwaites and the continued impact of franchise conversion within Taverns. Although the margin declined, Brewing division saw overall ale volumes up +13% with its largest brand, Hobgoblin sales up +13%. It also successfully expanded its market share to 27% of premium bottled ale and 20% of the premium cask ale markets. Operating margins at Destination and Premium remained unchanged at 20.5% despite the National Living Wage impact. Looking ahead, the Group suggested the first few weeks of the FY2017 had been "encouraging", that it had seen no noticeable change to the trends experienced in FY2016 and that it is well positioned to capture growth in FY2017. Marston's targets opening at least 20 new-build pub-restaurants, including 3 Revere bars and 5-10 lodges during FY2017 with majority coming in the H2. The period-end net debt to underlying EBITDA was reduced to 4.8x (end-FY2015: 5.1x) and the Group is expecting to reduce this further over time. Although the effects of cost-led inflation and general inflation are expected to hit the UK next year and weaken consumer spending power, we believe Maston's has sufficient momentum to achieve further growth and its progressive dividend policy aiming at a cover of around 2x over the medium-term should ensure attractive shareholder return. Given the shares are valued at FY2017E P/E of 9.9x along with dividend yield of over 5%, it remains attractive and Beaufort therefore reiterates its Buy rating on the shares.

Pets at Home (LON:PETS, 222.50p) - Buy

Pets at Home Group, the UK's leading specialist retailer of pet food, pet accessories, veterinary and grooming services, yesterday announced its interim results for the 28 weeks ended 13 October 2016 ('H1 FY2017'). During the period, Group revenue advanced by +9.1% to £441.3m, comprised of +4.7% increase in Merchandise revenue to £379.5m and +47.6% growth in Services revenue to £61.9m, against comparable period (H1 FY2016). Like-for-like ('LFL') revenue growth for the Group was +2.5% during the period, comprised of +1.9% and +8.7% LFL growth in Merchandise and Services, respectively. Gross margin declined by -0.15% to 53.9%. Statutory pre-tax profit jumped by +12.4% to £46m in absence of exceptional financial expense seen last year, while pre-exceptional (before £1m exceptional costs related to the disposal of Farm Away Limited on 4 October 2016) pre-tax profit rose +3.9% to £47m. Pre-exceptional basic earnings per share grew +3.7% to 7.4p per share. Free cashflow stood at £34.4m and net debt was £170.8m at the period end. Net debt to EBITDA (pre-exceptional) remain unchanged at 1.3x since the year end FY2016. On the operational front, the Group opened 8 new superstores, 17 vet practices and 18 grooming salons during the period. Just under a half of total superstores (c.210 superstores) has now both a vet practice and grooming salon inside. VIP club active members increased to 3.6 million (H1 FY2016: 3.1 million), while VIP card swipe rate (as % of revenue) stood at 65% (H1 FY2016: 67%). Pets at Home's CEO, Ian Kellett commented "In a more difficult trading environment, we continue to build Pets at Home for the future and are confident in the long term outlook for our unique offer in the resilient pet market, in particular, the developing potential of our Services business as we see it mature and grow". The Group declared an interim dividend of 2.5p per share, up +25%, to be paid on 6 January 2017.

Our view: Pets at Home reported good revenue growth during the H1 FY2017 supported by a growth in all divisions, particularly in accessories (within Merchandise) and Services. LFL sales growth was driven by vet and grooming services, omnichannel, Advanced Nutrition and Health & Hygiene products. Merchandise revenue growth follows the recent momentum, while LFL revenue growth improved. Services revenue hiked by +47.6%, while its LFL y-o-y growth slowed and against end-FY2016. Gross margin within Merchandise has expanded by +0.9% while in Service it dropped by -0.2% due to newly acquired specialist referral centres. The Group kept its guidance on gross margin and EBITDA margin unchanged. On the operational front, the Group's investment in omnichannel seamless shopping capabilities has driven improved online conversion, volume and average transaction values. We believe Group's ongoing strategic investments in seamless shopping should support merchandise sales (which enjoys a higher 57.5% gross margin) in the medium to longer term. For current trading, the Group said the environment is "more difficult" and noted recent trading has been "softer than in the first half". The Group however, as previously announced, has increased its dividend payout ratio to around 50% of earnings and said it will maintain this level for the FY2017. In line with Group's policy due to its US Dollar exposures, hedging for FY2017 and c.66% of expected FY2018 purchases are already in place. Recognising the Group's confidence in reiterating its increased dividend payout while achieving full year consensus profit expectations, Beaufort retains its Buy rating on the shares.

information and data may not be current and should not be relied upon.