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## SMALL COMPANIES

# Bargain shares: Exploiting information voids

Our small-cap stock picking expert highlights two under researched anomalously priced investment companies on his watch list.

July 5, 2021

By **Simon Thompson**

A key reason why I focus on stock picking under researched small and micro-cap companies is that I can gain an edge over other investors, hence why my Bargain Shares Portfolios have outperformed the market so consistently over the past two decades. This year is no exception.

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y motley crew of 10 small-caps have produced a total return (TR) of 21 per cent (28 per cent against magazine prices) using the market maker inflated opening offer prices on 5 February 2021. By comparison, FTSE Aim All-Share and All-Share indices have produced TRs of 5.5 per cent and 12 per cent, respectively.

The outperformance this year in part reflects my decision to target under researched investment companies. A good example is **Vietnam Holding** (VNH:265p), a little known closed-end fund that holds a concentrated portfolio of mid to small-cap companies to play secular growth trends in Vietnam. The shares have rallied 31 per cent to date, but still trade on an unwarranted 23 per cent discount to net asset value (NAV) even though the £145m fund has increased NAV by 47.6 per cent since the start of January, a seven-percentage point outperformance of the Vietnam All-Share index. The share price discount is worth exploiting. It's not the only one either.

### Royal investment prospects

- €10m investment in Switzerland-based provider of high quality generic prescription medicines.
- Analysts profit estimates fail to factor in increased cash receipts and earnings from the deal.
- Potential for fair value gains on portfolio driven by reversal of previous impairments and economic recovery.

**Duke Royalty** (DUKE:40p), an Aim-traded company that makes its money by providing capital to companies in exchange for rights to a small percentage of their future revenues, is putting to good use the £35m proceeds from April's oversubscribed equity placing (at 35p a share) and an increased revolving credit facility of £35m.

A new €10m (£8.6m) royalty agreement with Fairmed Healthcare gives Duke exposure to a company operating in well-established markets that have strong underlying demographic growth prospects. Fairmed is a provider of high quality generic prescription medicines, over-the-counter pharmaceuticals, and dietary supplements in various EU countries. It is majority owned by a subsidiary of **Strides Pharma Science** (STAR:NSI), a £681m market capitalisation Indian listed pharmaceutical company. Structured as a senior secured loan, the 30-year royalty agreement sits within Duke's typical investment terms (12 to 15 per cent annual royalty) as well as diversifying Duke's portfolio.

House broker Cenkos Securities is maintaining adjusted pre-tax profit estimates of £8.6m for the financial year to 31 March 2022, up from £5.2m in 2020/21, but analyst James Fletcher notes that Fairmed is "an additional investment above and beyond those we expected...and should further deployments [into new royalty partners] occur as expected, we would upwardly revise forecasts."

To put the scale of potential upgrades into perspective, Duke's pipeline of deals includes an £11m investment in an IT managed solutions business, £7.5m funding to a Canadian engineering and construction business, and £3.8m of funding to an existing royalty partner to facilitate the acquisition of a profitable company. Cumulatively, these three deals alone could generate £3m of annualised cash receipts in addition to £1.1m from the Fairmed deal, a hefty sum in relation to Cenkos' £12.7m cash receipt forecast for the 2021/22 financial year.

Moreover, with Duke's cash receipts increasing from £2.5m to £2.8m in the last quarter, so more than covering annual operating costs of £2.3m, then a significant amount of incremental cash receipts is now being converted into operating profit. Expect Cenkos to push through material earnings upgrades in due course. Improving cash flow is good news for the quarterly dividend of 0.55p a share, too.

Trading on a price-to-book value ratio of 1.3 times, offering a dividend yield of 5.5 per cent and a prospective yield of 6.75 per cent, I feel the 38 per cent re-rating since I included the shares in my **2021 Bargain Shares Portfolio** has further to run. That's because based on full deployment of Duke's available liquidity, my financial models suggest the company could be generating annualised cash receipts of £22m and free cash flow of £12.2m (3.4p a share) in the 2022/23 financial year to support a 3.1p annual dividend. A target price of 50p is not unreasonable given that upward resets of royalty payments from existing partners and a reversal of last year's Covid-19 induced asset impairments should drive up NAV sharply. **Buy.**

2021 Bargain Shares Portfolio Performance			
Company name	TIDM	Opening offer price 05.02.21	Bid price 05.07.21
San Leon Energy	SLE	27.5p	40.75p
Duke Royalty	DUKE	29p	39p
Vietnam Holding	VNH	201.4p	264p
Wynnstay Group	WYN	424p	540p
Springfield Properties	SPR	135.6p	165p
Ramsdens Holdings	RFX	142.8p	172p
Downing Strategic Micro-Cap Investment Trust	DSM	69p	75p
Canadian General Investments	CGI	3,611c	3,847c

Anexo	ANX	136.9p	144p
Arix Bioscience	ARIX	177p	177p

*Source: London Stock Exchange. Latest prices at 1pm on 5 July 2021.*

▪ Simon Thompson's latest book **Successful Stock Picking Strategies** and his previous book **Stock Picking for Profit** can be purchased online at [www.ypdbooks.com](http://www.ypdbooks.com), or by telephoning YPDBooks on 01904 431 213 to place an order. The books are being sold through no other source and are priced at £16.95 each plus postage and packaging of £3.25 [UK].

**Promotion:** Subject to stock availability, both books can be purchased for the promotional price of £25 with free postage and packaging.

They include case studies of Simon Thompson's market beating Bargain Share Portfolio companies outlining the investment characteristics that made them successful investments. Simon also highlights many other investment approaches and stock screens he uses to identify small-cap companies with investment potential. Details of the content can be viewed on [www.ypdbooks.com](http://www.ypdbooks.com).