

# UK Equities Contrarian funds

June 2017

**Alex Wright**  
Portfolio Manager

# Alex Wright

## Fidelity Special Situations & Special Values PLC



**Alex Wright**  
Portfolio Manager

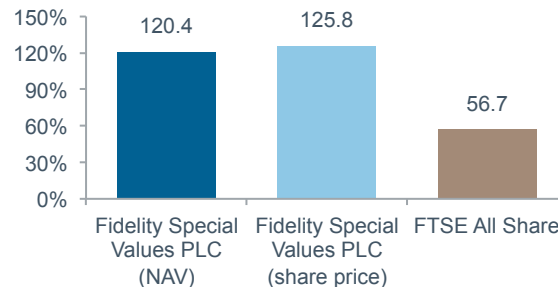
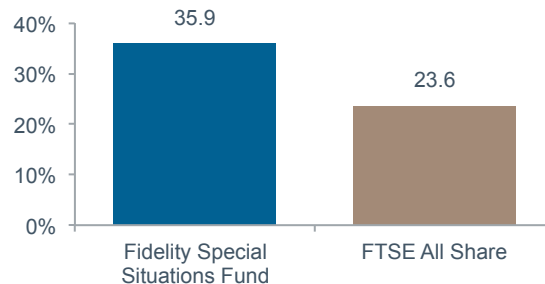
**Years of investment experience:**  
16

**Education:**  
BSc Hons Economics,  
Warwick University,  
CFA Charterholder

### Fidelity Experience

Fund Manager, Fidelity Special Situations	Jan 2014 – Present
Fund Manager, Fidelity Special Values	Sep 2012 – Present
Fund Manager, Fidelity UK Smaller Companies	Mar 2008 – Present
Pan-European sector analyst	2001-2008

### Performance over PM tenure



Source: Morningstar, 30 April 2017. Basis: bid-bid, income reinvested in GBP. For the Fidelity Special Situation Fund, the primary share class according to the IA is shown Peer group: IA UK All Companies. Peer group for Fidelity Special Values PLC: AIC UK All Companies sector. Holdings can vary from those in the index quoted. For this reason the comparison index is used for reference only. Past performance is not a guide to the future.

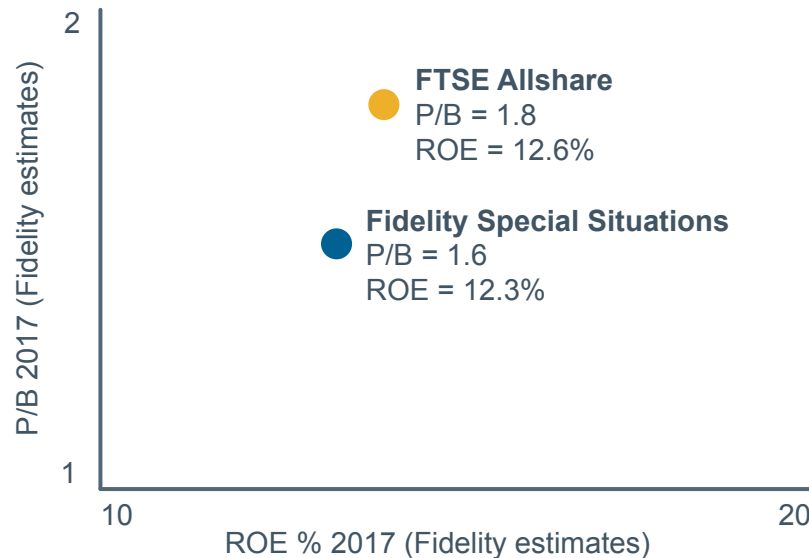
# Fidelity Special Situations

## Investment approach

- Looking for unloved companies with potential for positive change
- Portfolio shows a consistent value bias...
- ...but can perform well throughout different market conditions



### Fund as a stock – May 2017



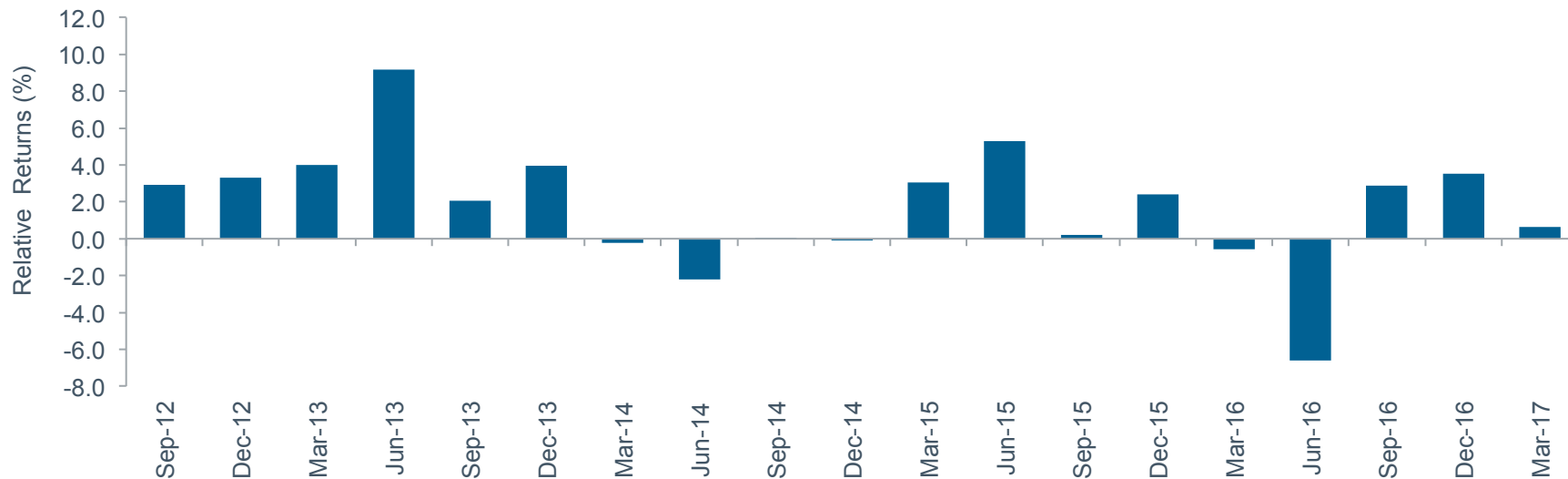
The portfolio is currently c10% cheaper than the market with similar earnings growth and quality

Source: Fidelity, May 2017.

# Alex Wright – Consistent long-term outperformance

## Fidelity Special Values - Relative performance

### Quarterly relative performance

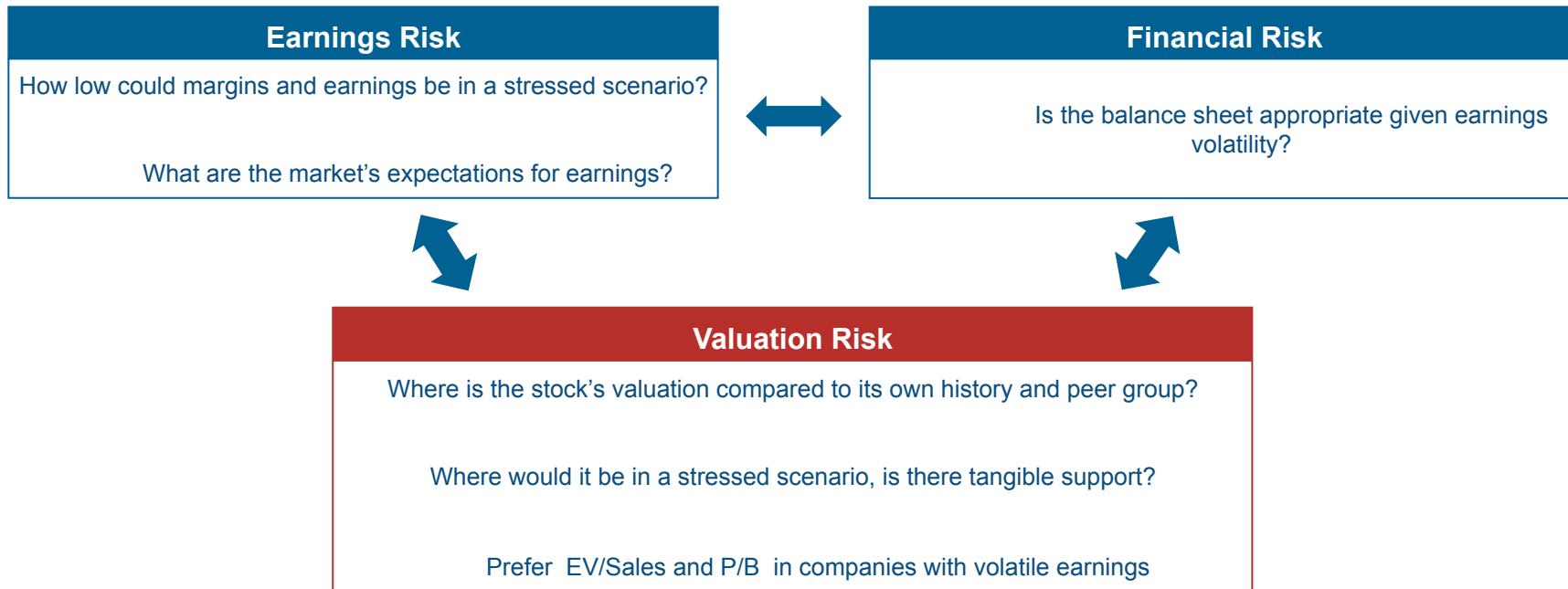


Strategy has a value bias but can perform well through different market conditions

Source: Fidelity International, as at 31 March 2017. Data is of Special Values PLC since August 2012, when Alex Wright took over the fund.

# How I look at companies

## 1. What could go wrong with an investment?



# How I look at companies

## 2. What could change for the better?

### Internal change

Looking for evidence of self-inflicted damage which can be fixed

New management teams preferred

Corporate activity

'Channel checks' allow us to assess credibility of change story

### External change

Supply reductions in low-return sectors

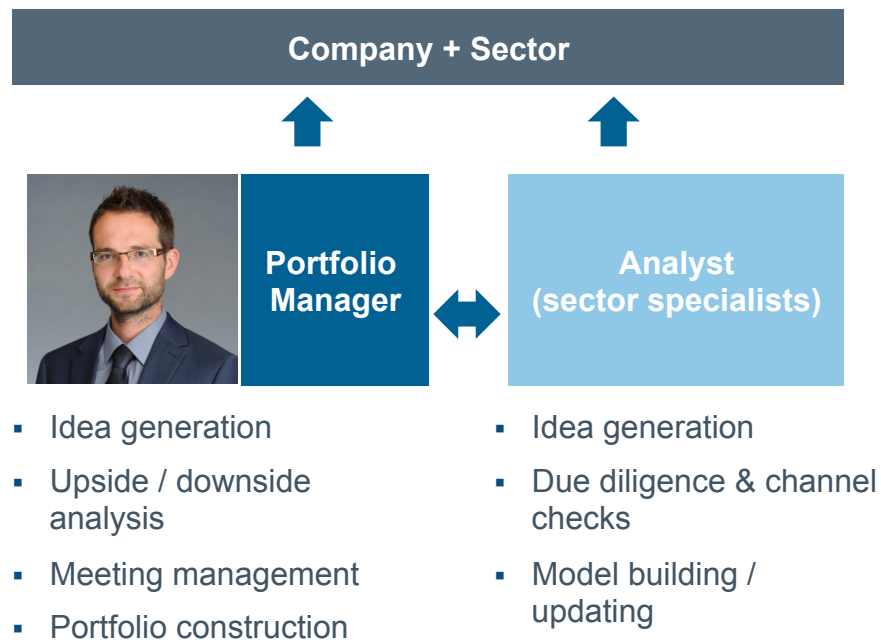
Regulatory or worries around disruption uncertainty can create opportunities

Macro environment considered but not critical to investment thesis

The market is often slow to recognise change in unloved companies

# Working with the Fidelity Research Team

- Ability of analysts to spend extra time meeting competitors, suppliers, customers, etc is a key competitive advantage
- Sell side research on unloved companies tends to be superficial and poor at anticipating change
- Focussing our research resources on unloved and poorly researched companies means we can be truly differentiated



The Fidelity Research team is critical to the success of the investment process

# Putting last year's rotation into context

## MSCI Global Value vs Growth



Over the very long term value tends to outperform growth



Though this has not been the case over the last 10 years



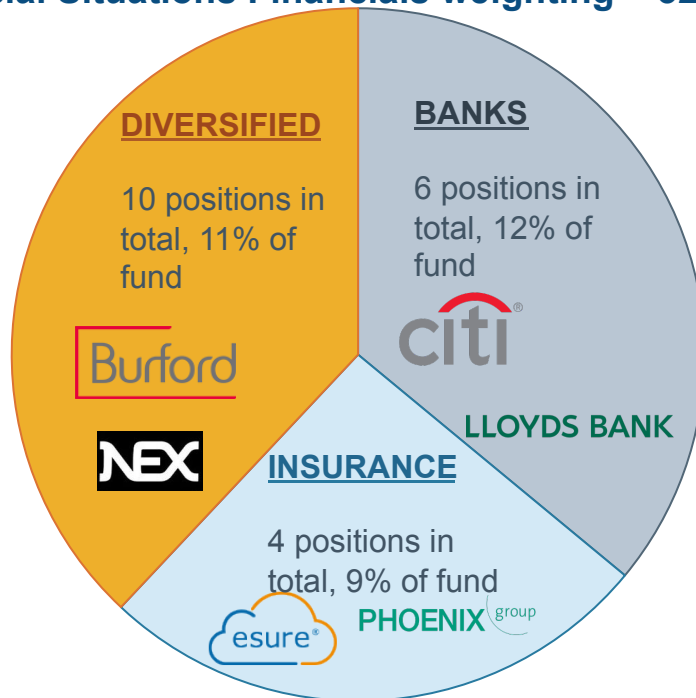
After a sharp rotation last year, growth has outperformed in 2017

Source: Datastream, 18 May 2017. MSCI Value relative to MSCI Growth



# Financials: more than just banks

Special Situations Financials weighting = 32%



Note: Relative weightings: Banks +1% ,Insurance +3%, Diversified Financials +4%.

Source: Fidelity International, April 2017

# Ladbrokes

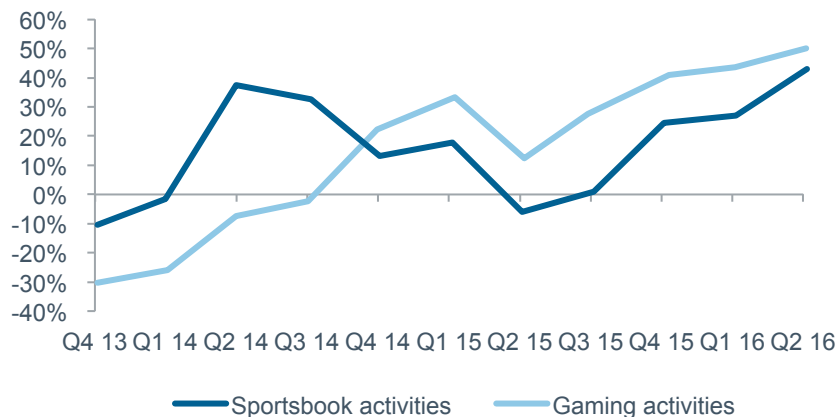
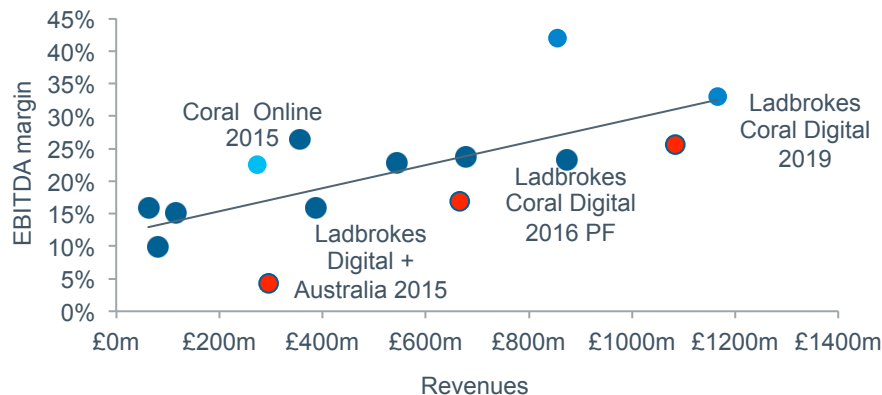
## Internal change – Coral deal is transformative

### Significant benefits to scale in online gambling

### Online becoming ‘best in class’

Bigger is Better – 2015 Revenues (£m) vs. EBITDA Margins (%)

LAD Online, Growth in Actives – Signs of improvement



- Significant cost savings are possible online and in retail estates
- Online gambling is highly operationally levered

- Online has previously been an underachieving area for Ladbrokes
- Signs of recovery should be supercharged by combining with Coral (who delivered 36% CAGR 2008-15)

**Positive momentum in digital being overlooked by the market**

Source: Fidelity, May 2017.

# Ladbrokes

## External change – regulatory uncertainty to reduce with time

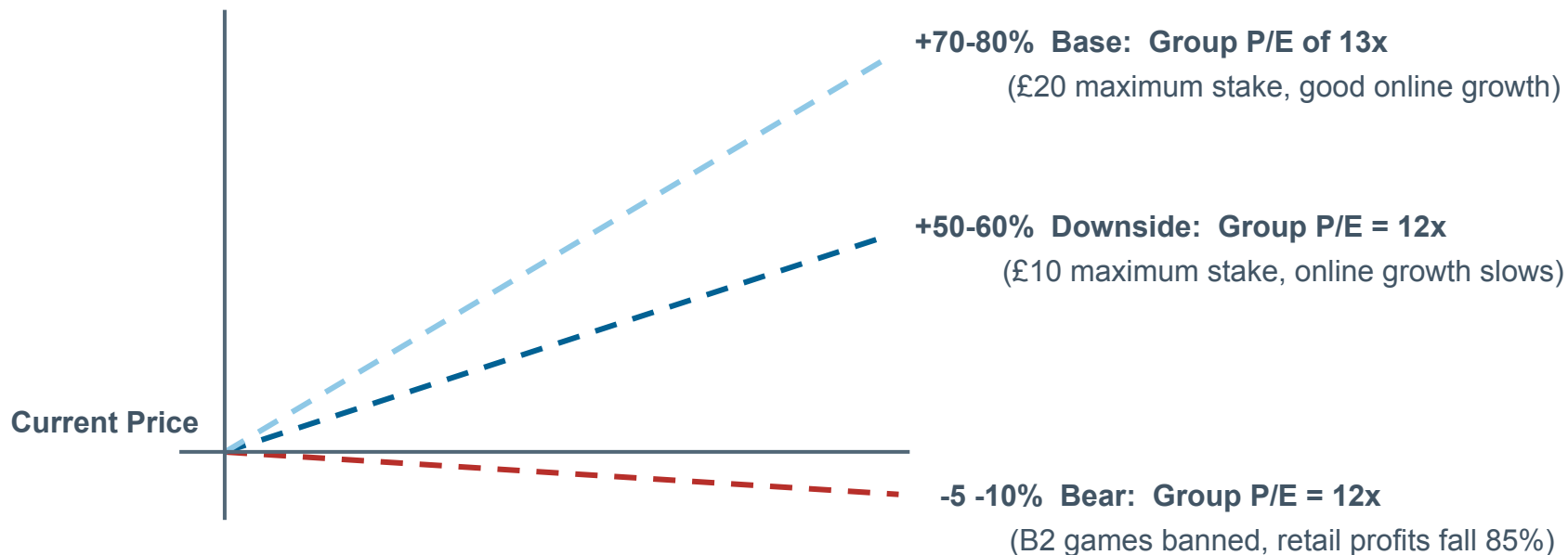
- Hard to find a UK industry where a regulatory review is creating more uncertainty around profitability
- Triennial review focusing on Fixed Odds Betting Terminals (FOBTs) – a very profitable part of the gambling industry – should report in 2017
- However, the company can mitigate these losses, and the market seems to be focussing on a worst case outcome
- Once the review is complete the company can articulate a retail strategy and investors will revisit the stock with more clarity



**Revenue will almost certainly be lost – but the market is overestimating how much**

# Ladbrokes

## Multiple outcomes from regulatory review are possible



**Are 3,600 shops really worth nothing to investors?**

Source: Fidelity, May 2017.

# Ladbrokes

## What kind of business could it be?

### Ladbrokes today

- Structurally compromised retail business is 70% of earnings
- Underachieving online business
- Net debt 2.7 x EBITDA
- 3.3% dividend yield but questions about sustainability



### Ladbrokes in 2 years

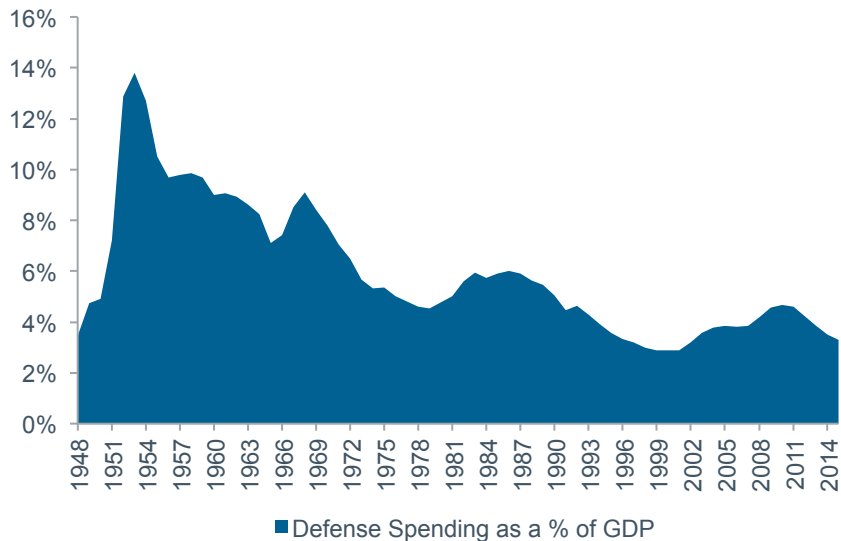
- Retail estate is stable or in slow decline
- Higher quality online business becoming majority profit driver (53% 2019 base case)
- Net debt 1.5 x EBITDA
- 6% dividend yield (at current prices) with potential for growth



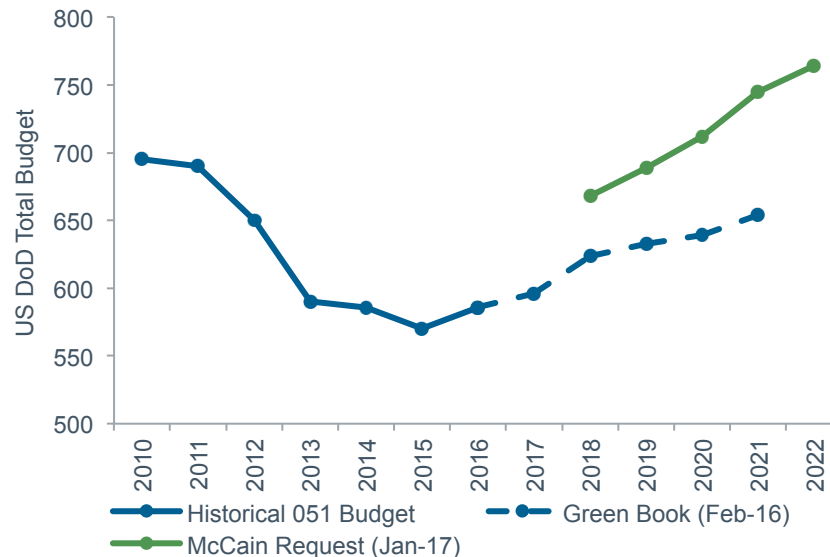
# Ultra Electronics

External change – More supportive environment for organic growth

US Defence Spending GDP at post-war lows...



...but are set to increase



**Ongoing disputes in congress could create a near-term headwind, though longer term the picture looks better**

Source: Fidelity International. Haver Analytics. 31 December 2016.

# Ultra Electronics

## Internal change – focus on higher growth areas of defence budgets

- Ideally positioned for current geopolitical environment
- Higher R&D spend vs peers and strong positions in high-tech, higher growth niches
  - Underwater
  - Communications & surveillance
  - Cyber
- Should be able to out-grow defence budgets



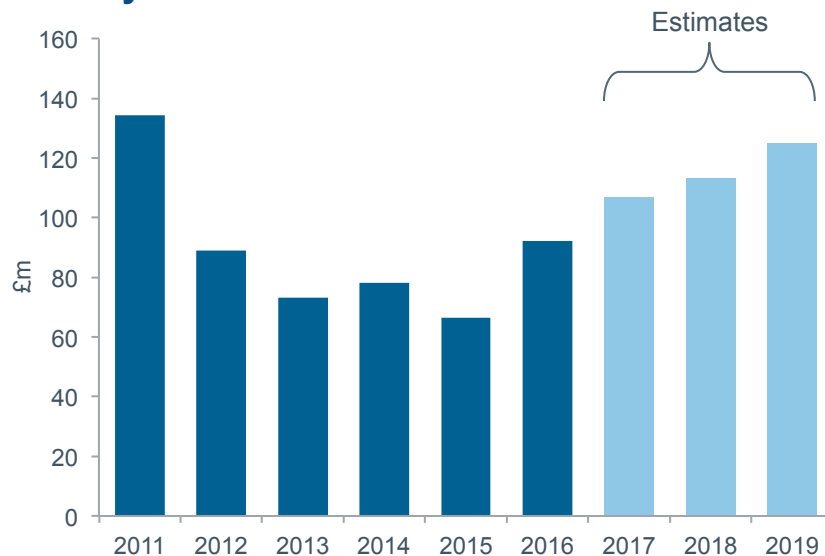
**Demand for products driven by rising tension rather than action**

# Ultra Electronics

## Internal change – FCF set to recover

- Cash conversion can improve after the disruption from Oman contract
- Business has been built by M&A, resulting in duplication of cost centres
- 'S3' program is designed to better integrate business units and achieve cost savings and better cross-selling

### Fidelity estimates of FCF



**Our estimates are for a c6% FCFY in 2018**

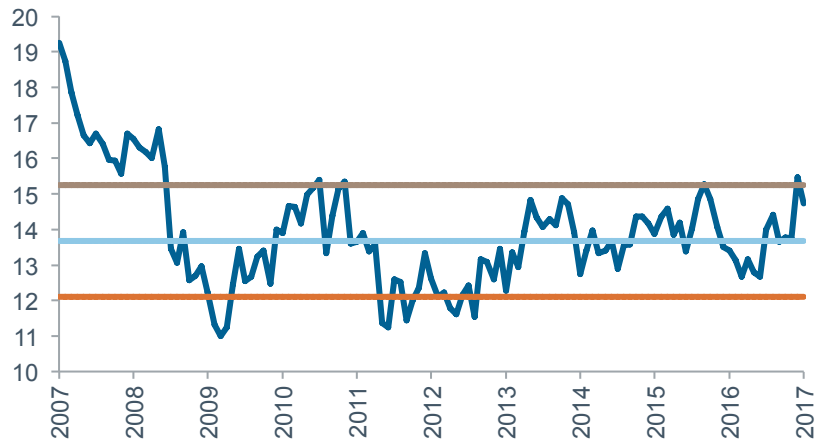
Source: Fidelity, February 2017.



# Ultra Electronics

## How do I value the stock?

### 12 month forward PE



### Relative 12 month fwd PE vs. FTSE All Share



**Downside =**

- 12x P/E on trough margins

**Base Case =**

- 16x P/E on stable margins

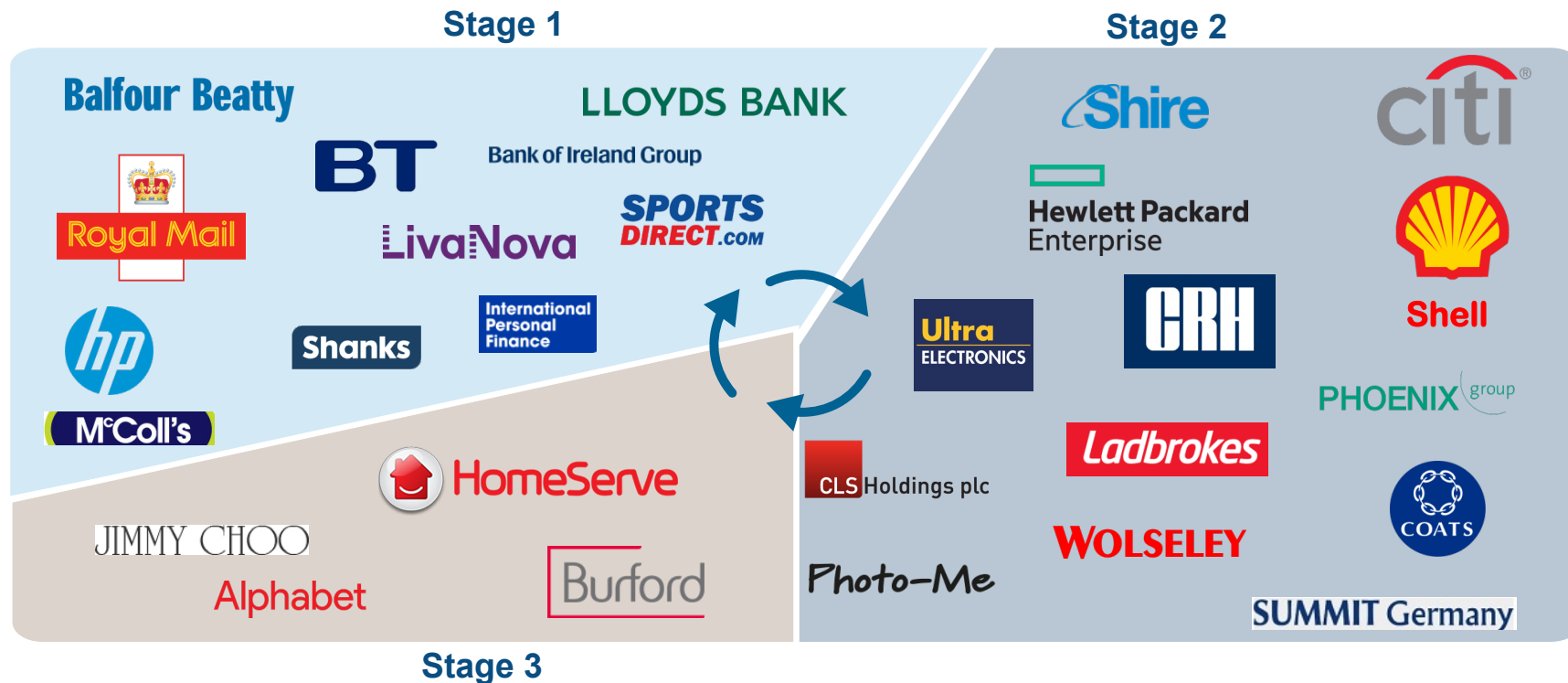
**Bull case =**

- 16x P/E on stable margins + growth

Source: Fidelity International, DataStream, May 2017.

# Stages of working

Owning unloved companies through a period of positive change



Source: Fidelity, March 2017. Not exhaustive list of holdings

# Important Information

"This information is for Investment Professionals only and should not be relied upon by private investors. It must not be reproduced or circulated without prior permission. This communication is not directed at, and must not be acted upon by persons inside the United States and is otherwise only directed at persons residing in jurisdictions where the relevant funds are authorised for distribution or where no such authorisation is required. Research professionals include both analysts and associates. Assets and resources as at 29/02/2012 are those of FIL Limited. Data is unaudited. Fidelity/Fidelity International means FIL Limited and its subsidiary companies. Unless otherwise stated, all views are those of Fidelity. Top security holdings are those companies in which the largest percentages of the fund's total net assets are effectively invested. Positions in other funds - including ETFs (Exchange Traded Funds) – can appear in this table, but index derivatives form part of an "Other Index / Unclassified" category which will not appear. Reference in this document to specific securities should not be interpreted as a recommendation to buy or sell these securities, but is included for the purposes of illustration only. Investors should also note that the views expressed may no longer be current and may have already been acted upon by Fidelity. The research and analysis used in this documentation is gathered by Fidelity for its use as an investment manager and may have already been acted upon for its own purposes. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. Fidelity only offers information on products and services and does not provide investment advice based on an individual's circumstances. The value of investments can go down as well as up and investors may not get back the amount invested. For funds that invest in overseas markets, changes in currency exchange rates may affect the value of an investment. Foreign exchange transactions may be effected on an arm's length basis by or through Fidelity companies from which a benefit may be derived by such companies. Past performance is not a reliable indicator of future results. Fidelity reserves the right to withdraw or alter any cap on expenses in the future. Please refer to the Key Investor Information Document (KIID) for the relevant fund for further details on expenses. The Authorised Corporate Director of Fidelity Investment Funds and Fidelity Investment Funds IV OEIC, and the Manager of Fidelity Unit Trusts is FIL Investment Services (UK) Limited. Please note Fidelity Unit Trusts are not registered for sale in Jersey or Guernsey. This document may not be reproduced or circulated without prior permission. No statements or representations made in this document are legally binding on Fidelity or the recipient. Some funds invest more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies. Data Source – © 2014 Morningstar, . All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Copyright – © 2014 Morningstar . All Rights Reserved. Morningstar Rating™ as of 29/02/2012. Third party trademark, copyright and other intellectual property rights are and remain the property of their respective owners. Issued by FIL Investments International (FCA registered number 122170) a firm authorised and regulated by the Financial Conduct Authority. FIL Investments International is a member of the Fidelity International group of companies and is registered in England and Wales under the company number 1448245. The registered office of the company is Oakhill House, 130 Tonbridge Road, Hildenborough, Tonbridge, Kent TN11 9DZ, United Kingdom. Fidelity International's VAT identification number is 395 3090 35. "

UKSSO11284