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The Southbank

Private Briefing

Beta

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- **Charlie Morris: time to buy Britain**
- **Tim Price: "witch doctor" economists**
- **Saudi Arabia in hot water**
- **Vern Gowdie: how to prosper in a high-tech world**
- **Dr. Michael Tubbs: Wirecard expects its transaction volumes to rise nearly 5x by 2020**

Henry Bonner

Welcome back to The Southbank Private Briefing. In this week's edition, we'll cover Charlie Morris' latest insight on the British stockmarket, published earlier in a Fleet Street Letter update.

Charlie's taken a different stance from Tim Price, who believes that we are probably at a peak in US stock prices which could lead to a future drop. And that would also affect UK stocks, which tend to trade in line with the US and the rest of the world.

In the latest update from Charlie Morris, he continues from last week's update on banks… where he said that Lloyds and RBS were mostly fixed – eight years after the mortgage meltdown. He called today's relatively low valuations in UK stocks a buying opportunity, adding that they were more attractive than gilts.

To read more from Charlie's latest update, just continue reading for today's first story below.

Then, as a Premium subscriber, you'll see a special excerpt from Tim Price's latest in The Price Report. He makes the case that you'll only really make money if you get the broad trend right – and stick to it. But in order to act rationally, you need to understand the story you're buying into… and the biggest mistake you can make is to buy into a narrative that you're being sold – and that will soon become obsolete. This happens often when you listen to the economists and columnists you'll read in the mainstream press.

Then we've got a special interview from our friends at Bonner & Partners, located across the pond. Conducted with a long-time analyst of "crisis investing" – a disciple of famed investor Doug Casey –, you'll hear why today's oil situation isn't going to end well for Saudi Arabia… and why this creates an opportunity today.

Finally, we'll end today's Briefing with a note from Vern Gowdie to his high-end Gowdie Family Wealth subscribers. Located on the Gold Coast of Australia, Vern, whose mission is to leave behind a substantial amount of wealth for his three daughters, shares his insights on a regular basis with paid subscribers.

Next week, a new edition of The Bill Bonner Letter will hit our inboxes. So look forward to an update with Bill's latest on the global assault on you and other savers.

Save the Date

Monday, October 3rd, 2016

The MoneyWeek Research Conference will be held at 155 Bishopsgate in London

8am – 7pm

Watch for details soon

British stocks are cheap – time to buy

Charlie Morris, *Fleet Street Letter*

I could show you dozens of charts that prove the end of the world is imminent. I won't bother, because the bond market is telling you that the US economy is alive and kicking. The message from US Treasuries overrides everything. Inflation is rising, and bonds will fall (prices fall, yields rise). That's potentially supportive for the stockmarket.

Look at the following chart:

Fig.1 Source: Bloomberg (The white line shows you US consumer price inflation (CPI), and the yellow line shows core inflation, which strips out food and energy.)

The red line shows you US consumer price inflation (CPI), and the black line shows core inflation (core); which strips out food and energy.

As you can see, core is 2.1% and CPI is 1.1%. The latter collapsed in late 2014 as oil fell. However, at no stage did it challenge the lows seen at the depths of the credit crisis in 2008. Core didn't respond to oil's collapse either. Now that commodity prices are rising, the officials at the Federal Reserve are concerned that rates are too low. Unemployment in the US has collapsed. That has led to a pick-up in wage growth, and the normal relationship is that inflation follows closely behind.

So far, Britain has been left behind

This chart shows the capital return (excluding dividends) of investing in the FTSE 100 compared to the rest of the world (MSCI World Index).

Fig.2 Source: Bloomberg (This chart shows the capital return excluding dividends of investing in the FTSE 100 compared to the rest of the world (MSCI World Index).

Between 1984 and 2007, British shares behaved in a very similar manner to the world at large. The range, on the right hand axis, has been relatively narrow. Since 2012, British shares have lagged considerably. Not only have they lagged the US, they've also lagged Europe. Now that's saying something.

In part, that's because the UK was a safe haven during the European debt crisis in 2011. However, it's also due to the high weighting of commodity stocks and banks in the FTSE 100. Clearly that's hurt. More recently, global investors have dumped British shares over Brexit fears. The result of all this shows you that British shares are not only cheap, but also under owned by institutional investors – especially the pension funds.

When I consider how great Britain is, our stockmarket has been left behind and there's an opportunity for you as an investor.

The Brexit vote is coming soon. The polls say we're staying in. Whatever your view, we should all be grateful that our nation has enjoyed a healthy debate. We all understand the issues more clearly than before, and even the Remain camp recognises the EU needs to reform and be more accountable. This exercise will have been of great benefit to the whole of Europe.

But the referendum isn't over yet. If we stay, I see a strong rally in British shares. If we leave, I believe the "impending collapse" is greatly exaggerated. In any event, we should be buying Britain.

Get the broad trend right, results will follow

Tim Price, *The Price Report*

I'm no great fan of financial journalists in general, but I make an honourable exception for Jason Zweig – personal finance columnist for The Wall Street Journal.

Zweig describes his mission as follows: "My job is to write the exact same thing between 50 and 100 times a year in such a way that neither my editors nor my readers will ever think I am repeating myself."

As Zweig puts it, good advice rarely changes, whereas markets change constantly: "The temptation to pander is almost irresistible. And while people need good advice, what they want is advice that sounds good."

Zweig sees his role as betting on regression to the mean while most investors, and financial journalists, are betting against it.

Betting on broad trends, instead of trying to make a quick buck going in and out of stocks, is your best chance to make money with investing.

But you have to get the trend right, and in order to do that you need to avoid getting suckered into a good-sounding story – one that everyone already believes.

Economists: story-telling witch doctors

One of my favourite analysts is Russell Napier, whom I've quoted within *The Price Report* on numerous occasions. One reason is that Napier is a financial market historian (his two-day course, A Practical History of Financial Markets, is one of the most enjoyable two days I've spent professionally). Another is that he acknowledges that we are all engaged in a process of lifetime learning that never quite comes to an end. I remember him making the disarming remark recently that few other jobs pay so highly for its practitioners to learn as they go along as those in financial services.

Which is probably why I have so much antipathy to economists. I cannot think of a profession with more unwarranted vanity about how little it collectively understands. The hubris is often breathtaking. The author Satyajit Das reports this telling anecdote:

> Most economists, it seems, believe strongly in their own superior intelligence and take themselves far too seriously. In his open letter of 22 July 2001 to Joseph Stiglitz, Kenneth Rogoff identified this problem. "One of my favourite stories from that era is a lunch with you and our former colleague, Carl Shapiro, at which the two of you started discussing whether Paul Volcker merited your vote for a tenured appointment at Princeton. At one point, you turned to me and said, "*Ken, you used to work for Volcker at the Fed. Tell me, is he really smart?*" I responded something to the effect of, "*Well, he was arguably the greatest Federal Reserve Chairman of the twentieth century*." To which you replied, "*But is he smart like us?*"

Today's most dangerous narrative

Even if the information behind a Narrative is not a deliberate lie, it may have little or nothing to do with the Narrative itself. The financial news media have to say something, and they have to be saying something all the time. So they will.

The trick is a) to identify the Narrative without b) necessarily choosing to believe the Narrative. The current Narrative of our time, I think, holds that central bankers are capable of supporting and manipulating the financial markets so as to create a controllable level of inflation. I don't happen to accept that Narrative, but that doesn't matter. What matters is that a sufficient number of other investors believe it. This Narrative used to comprise the saying, "Don't fight the Fed."

Whether or not we really believe that the US Federal Reserve can support the stockmarket indefinitely, what matters is that enough other investors believe it can. Since this Narrative is itself becoming increasingly questioned in the eyes of the average investor, it makes sense to own portfolio protection for a period in which a growing number of investors stop believing that Narrative.

Given that we are talking about the stability of the monetary system itself, the logical portfolio insurance to hold ahead of the Narrative changing is gold

Publisher note (From Dan Denning): for now, the other telling point is that most investors don't spend time thinking about whether the Fed is right. Most investors don't care. But I think, ironically, by putting itself at the centre of the economic calculation process, the Fed may have set itself up for a fall. It wants people to pay attention to it so it can influence expectations about inflation and therefore economic behaviour. But by drawing attention to itself, people *are* paying attention to it. And the more they look, they more they see these people are clowns who are making it up as they go along. That hardly inspires confidence. Or belief.

Saudi Arabia "overplayed its hand" against US in oil fight

Nick Giambruno, *Casey Research,* interview by Chris Lowe, *Bonner & Partners Inner Circle*

Inner Circle (IC): Before we talk in detail about the latest opportunity you have in your sights, can you talk about the process you use for tracking down crisis investments?

Nick Giambruno (NG): There are a number of things I look for. *Crisis Investing* is a sector-neutral and country-neutral publication. It doesn't matter where these investments are located. The common thread is that all of the investments I recommend to my readers are hated because of a crisis. So, they are selling at bargain prices.

I also pay special attention to dividends. Dividends are the most reliable simple indicator of true value. You can believe in the cash payments landing in your pocket.

Reported earnings aren't as reliable: it's too easy for a company's management to pump them up by choosing the right accounting formalities. Book value is just as susceptible to manipulation. Stretching facts (or ignoring them) can push book value toward whatever management wants it to be.

Also, accounting and reporting standards vary widely across the world. Dividends, on the other hand, are actual cash payments. They are real. And nothing is easier to measure or harder to fake. It's astounding what you can get in dividends alone when a market reaches bottom, something a lot of people have forgotten.

Lastly, I keep things simple. You can access all the stocks and funds I recommend with a US brokerage account.

IC: But if the crises you're tracking are happening outside the US, are those opportunities easy for Americans to invest in?

NG: You'd be surprised how many far-flung places you can invest in through US-listed stock and funds.

For example, many overseas stocks are also listed in the US as American depository receipts – known as ADRs. These are stocks that are sponsored by a US bank or brokerage. They trade in the US but represent a certain number of shares in an overseas company. They were introduced in the 1920s to make it easier for Americans to invest in overseas companies.

You also have hundreds, if not thousands, of exchange-traded funds – or ETFs, as they're more commonly known – that give you exposure to foreign markets. ETFs are funds that you can buy or sell on an exchange just like a regular stock. Just as with ADRs, you can easily access them through your regular US brokerage account.

IC: One of the crisis investing opportunities currently on your radar is in the oil patch. What's your investment case?

NG: As your readers will be aware, oil has been completely shellacked over the last 22 months. It's plunged roughly 70% from peak to trough. And even though it's bounced about 60% off its recent low, a lot of people are just steering clear. As a crisis investor, that's music to my ears.

The big factor I'm homing in on right now is Saudi Arabia. After the US, Saudi Arabia is still the world's biggest oil producer. And the Saudis have saturated the market for some time now as a strategic move to undermine their competitors and their geopolitical rivals.

As I told my *Crisis Investing* readers, the Saudis know all about the devastating power of using oil as a weapon. They used it during the 1973 oil embargo to bring the Western economies to their knees. They also used it in 1986, when they successfully pushed the price of oil down to $10 a barrel. Most people don't know it, but this paved the way for the collapse of the Soviet Union five years later.

Make no mistake: the Saudis' geopolitical aims are no less ambitious today.

IC: When you say "geopolitical rivals," who do you mean?

NG: First, the Saudis want to hurt Russia for supporting their regional rival, Syrian president Bashar al-Assad. They also want to hurt Iran, their age-old geopolitical rival in the region. Russia and Iran depend heavily on oil sales.

But as I recently told *Bill Bonner's Diary* readers, the Saudis have also declared war on the US shale oil industry.

In the 1990s, the US imported about 25% of its oil from Saudi Arabia. Today – because of high US shale oil production – we import only 5% of our oil.

By keeping the market saturated with oil, the Saudis are driving down the price. They hope to drive it down low enough, and keep it there for long enough, to bankrupt the shale industry.

IC: But wouldn't that also bankrupt the Saudis?

NG: It's a great question. Shale

oil costs more than Saudi oil to produce. So, shale becomes uneconomic before Saudi oil does. The Saudis reckon that will knock out their US shale oil competitors and let the Saudis regain lost market share.

But I did an in-depth analysis of this in a recent issue of *Crisis Investing*. And I believe the Saudis are making a huge miscalculation. Yes, they have some foreign-exchange reserves to help them weather the fall in state oil earnings, but the truth is they've created an existential crisis for themselves.

The Saudis have had some success in damaging shale oil producers. For instance, in the past year, at least 67 US oil companies have filed for bankruptcy. Analysts estimate as many as 150 could follow. And they'll continue to cause more damage. But the US shale industry has more staying power than Saudi Arabia. Some shale producers are profitable at $40 oil. And their pace of innovation will drive that break-even cost even lower.

This offers contrarians a second bite at the American shale revolution. That's because investors have priced the best US shale oil companies back to levels they were at before they had all of this wealth in the ground. So, it's a second chance, but with the benefit of hindsight, to go back and buy these companies at very low valuations.

IC: You're saying the Saudis have overplayed their hand and will be forced to cap production to push oil prices – and vital state oil revenues – higher?

NG: Yes. They have overplayed their hand – big time.

This doesn't get a lot of coverage in the news. But in addition to supporting anti-government fighters in Syria, the Saudis have launched a costly war in neighbouring Yemen. And it's going badly.

Frankly, that was easily predictable. Yemen is one of the most inhospitable places in the world for a foreign military. Also, the Saudi military is a joke. They have some fancy toys. But when it comes to man-to-man combat, even a lowly Yemeni peasant has the upper hand.

It's really no surprise that when it comes to a ground war, the Yemenis are kicking the Saudis' butts. The Yemenis are making no more than $500 a year. They are a poor people. But they're tough. The Saudis, on the other hand, are rich and pampered. They haven't been exposed to this kind of harshness.

IC: Are you seeing signs that a crack-up in Saudi Arabia is underway?

NG: One important indicator I'm keeping a close eye on is the Saudi currency, the riyal. Since 1986, it has effectively been pegged to the US dollar – at 3.75 riyals to the buck. Now, for the first time ever, the riyal is coming under attack from investors who think that this peg can no longer hold.

Take hedge fund manager Zachary Schreiber, a protégé of legendary investor Stanley Druckenmiller. At the recent Ira Sohn Investment Conference in New York, Schreiber warned that Saudi Arabia would be "structurally insolvent" in two to three years. He reckons the Saudi economy needs $90 oil just to stay solvent. Right now, a barrel of Brent crude oil – the international benchmark – is trading at under $50.

The Saudis have responded by banning speculation in the currency markets… at least within their borders. When you crunch the numbers, it's clear that the Saudis may be able to keep pushing down the price of oil for another year or so at the most. Then they are going to face a big problem.

Saudi Arabia faces massive social unrest if they don't find money from somewhere. Again, you don't hear about it in the news much. But one-quarter of the population lives in poverty and is completely

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dependent on state handouts. Youth unemployment is a staggering 29%.

Saudi Arabia, don't forget, is an absolute monarchy. The king – who is also prime minister – rules by decree. The country is also a theocracy that's built around the ultraconservative Wahhabi movement within Sunni Islam. It's utterly brutal. There are dozens of public beheadings there every year.

But what really keeps the average Saudi population pacified is cradle-to-grave welfare… and no taxes. If the House of Saud decides to spend all its money on a war in Yemen along with a proxy war in Syria… if it continues to flood the market to flush out its competitors… well, it's going to have a serious budget crunch.

If the Saudis want to maintain their currency peg… which requires them to have a large stash of US dollars… there's simply not enough money to go around for the bread and circuses that there were before. So, one way or another, they're going to be forced – either through an internal collapse or from external pressure on the currency – to abandon their strategy.

IC: How does this translate into an investment opportunity for *Inner Circle* members?

NG: When the Saudi royals finally throw in the towel and cap oil production, we'll see a big spike in the oil price. That will benefit beaten-down US shale oil producers.

I'm not necessarily bullish on the entire energy sector. I'm using the temporary anomaly in the market caused by this doomed Saudi strategy to pick up the high-quality shale companies.

The "best of breed" companies will survive even if the Saudis continue their strategy into perpetuity. These guys are making money at $35, $40 oil. They own the best trophy assets in the US in terms of the shale plays. They're going to do well, no matter what.

IC: What specific companies fit the picture?

NG: One company I'm particularly bullish on right now is EOG Resources (EOG).

As I told my *Crisis Investing* readers, EOG has been the leading shale oil producer. And it has a reputation as an excellent operator and cost-cutting innovator. EOG has trophy assets in the major US shale basins. It has a solid balance sheet. And unlike many of its peers, it didn't overleverage itself during the last boom.

Out of all the US shale oil companies, it's in the best position to survive the Saudi oil war and make huge profits when it's over.

IC: What are the risks involved in this crisis investment?

NG: Your readers should keep in mind that this is not a short-term trade on oil-price volatility. It's a long-term play on the fall of the House of Saud.

The key to winning the oil war is understanding that it's a marathon, not a sprint. EOG understands this. The Saudis, clearly, do not.

The opportunity and threat from smarter technology

Vern Gowdie, *Gowdie Family Wealth*

Billionaire bond fund investor Bill Gross, of Janus Capital Group, publishes a monthly newsletter that is on my must read list. This month's newsletter contained the following graph:

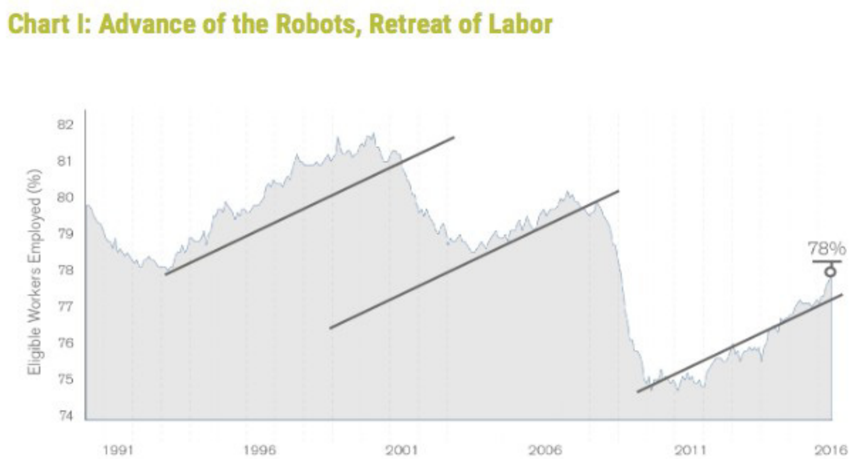


Fig.3 Source: U.S Bureau of Labor Statistics

The left hand scale is the percentage of eligible workers (aged between 25 and 54) employed. The dips in the chart denote US recessions, during which the labour force was negatively impacted.

After the recession in the early 1990s, the employment participation number peaked in 2000 at 82%. Since then, the percentage has never recovered to that level.

While the current participation rate is 78% (only 4% below the peak), Bill Gross puts it into a human perspective.

Gross' theory on the declining trend in the graph, is that the gradual implementation of automation in the workforce is making jobs redundant.

The uptake of automation and robotics has been one of the pillars supporting my theory for deflation – along with credit contraction and demographics.

Ironically, central banks are, to some degree, hastening the onset of this deflationary force with their policy of low interest rates.

Businesses weighing up the cost of labour versus the cost of investing in automation have access to the lowest lease or commercial lending rates in history.

The other side of the equation is that technology is not yet available for businesses on that scale to be wholesale job disruptors. But it is coming. To quote Bill Gross:

I speak in this [Monthly Investment] Outlook to information technology and the robotization of our future global economy. Virtually every industry in existence is likely to become less labor-intensive in future years as new technology is assimilated into existing business models. Transportation is a visible example as computer driven vehicles soon will displace many truckers and bus/taxi drivers. Millions of jobs will be lost over the next 10–15 years.

But medicine, manufacturing and even service intensive jobs are at risk. Investment managers too! Not only blue collar but now white collar professionals are being threatened by technological change.

When he says "Investment managers too!" he's talking about exchange-traded funds (which are algorithms that replicate any given index) being recommended by roboadvisers… this is already happening in the US.

The threats that I see coming are on a personal and familial level.

Personally, our children need to be aware of the risks to their future employment opportunities. They must invest in themselves to offer skills, knowledge and expertise that cannot easily be outsourced to technology. This will be our priority – making sure they have access to opportunities for self-development.

From a family perspective, the potential threat I see is to our wealth. My theory was that the wholesale introduction of automation would most likely herald a prolonged period of deflation.

Gross gave me some food for thought on this theory.

He quoted Nobel Prize winning economist Michael Spence, who, in 2014, wrote: "[Should] the digital revolution continue… The structure of the modern economy and the role of work itself may need to be rethought."

His argument is that the role of work will require a complete rethink on how we provide income to those displaced by automation. Gross is of the opinion that a Universal Basic Income (UBI) is what will be introduced to provide people with sufficient funds to cover life's necessities… a sort of ramped up and permanent dole payment.

With fewer people in the workforce paying taxes, and more people moving into retirement, where will the money come from?

… the money can be printed by central banks as it has been recently. It's a hard concept to understand and that's why politicians never discuss it — nor do most central bankers, who want to preserve the sanctity of their "balance sheets" and independence of their institutions. But the independence between central banks and government is rapidly eroding — a new culture is forming if only by necessity. Printing money via QE is in effect a comingling of monetary and fiscal policy, of central bank and treasury. The Fed, the ECB, BOJ and BOE have in effect bought bonds from their treasuries for 6 years now in order to allow them to spend money in support of their sagging economies.

Based on the principle that "hungry people riot", it's not difficult to envisage governments introducing policies that require permanent money printing to ensure societies remain relatively peaceful.

Helicopter money – dropping money from the skies – was meant to be a limited policy response. Kick-starting an ailing economy by putting cash directly into the hands of consumers. Similar to Rudd and Swan's $900 cheques.

The advent of automation means we could see the printing presses running indefinitely to finance permanent helicopter money *and* to create employment via government spending on infrastructure and aged care.

The prospect of indefinite and unquantifiable money creation could unleash inflation – *not* the deflation I had envisaged.

This has me thinking that any weakness in the gold price could provide an opportunity to hedge our bets on the inflation versus deflation outcome.

Acknowledging the threats – personally, and on the family – leads me to think of the opportunities.

Rather than being a taker of technological outcomes, you can also be a maker. Look for business and investment opportunities that enable you to capitalise on the trend.

The obvious one is marketing products online. However, everyone is looking to make money on the internet; being heard in a crowded and noisy marketplace is very difficult.

This doesn't mean you discount the opportunity, though. You just have to approach it from a different angle. We will be discussing this in London... the younger generation are far more in tune with this market than I am.

Also, we'll be trying to identify investment opportunities. Looking for "the pan seller in a gold rush". Which companies are providing the tools of trade that others hope will make them their fortunes?

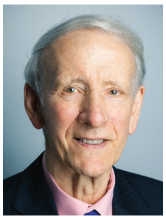
The answers to these opportunities are not evident at this stage. However, in asking ourselves the questions, we're opening up our subconscious to possibilities, ideas and the gathering of relevant information.

Asking "how can I?" instead of saying "I can't" puts the subconscious on notice that you're seeking more information. The subconscious will then go on a "seek and discover" mission for you. As an aside, the powers of self-talk (positive and negative) – the quality of the questions you ask and the words you use – is another important intangible we've stressed upon our family.

Editor's note: To end today's *Briefing* (for Premium subscribers only), here's a snippet form Dr Michael Tubbs' latest work. Dr Tubbs writes a regular update on a handful of companies that are leaders in research and development. Here is what he recently wrote about two companies he follows: Wirecard, a digital payments company that is growing thanks to the massive amount online payments happening; then there's an update on AVEVA, which writes software and engineering expertise for specialised high-tech industries – think billion-dollar defense contracts in Europe or modelling underground oil extraction in the Middle East.

Wirecard expects its transaction volumes to rise nearly 5x by 2020

Dr. Michael Tubbs, *Research Investments*



Wirecard riding the online payments boom...

Wirecard, the payment processing company, has set out its vision for 2020. It sees annual transaction volumes rising from €34.3bn in 2014 to over €160bn. And that means revenue is expected to rise from €771.3m to over €2.1bn by 2020. The EBITDA (earnings before interest, tax, depreciation and amortisation) margin (EBITDA as % sales) would then rise from 29.5% in 2015 to 30-35% in 2020. Revenue growth of over 172% in five years is fairly rare in a company of Wirecard's size (€4.6bn market cap).

Wirecard's growth is driven by three factors – the growth of the general ecommerce market, the higher growth of that market in Asia where Wirecard is strong and contributions from M&A and partnerships. The global ecommerce market is expected to grow by 16-17% in 2016 whereas Asian markets are expected to grow by 25%. And Wirecard is the leading payment service provider in Southeast Asia with subsidiaries in Australia, India, Indonesia, Malaysia, Myanmar (Burma), New Zealand, Singapore and Vietnam.

Q1 profits are up 38%

We'll now take a look at Wirecard's Q1 results to end March:

- Transaction volume **up 35%** to €12.8bn (29.3% organic growth)
- Revenue **up 32%** to €210.5m (20.1% organic growth)
- EBITDA **up 35%** to €62m (26% organic growth)
- EBIT **up 38%** to €46.1
- Eps **up 30%** to €0.30
- Free cash flow (operating cash flow less capex) of €37.5m and net cash of **398m**

These are strong results, with the great majority of growth being organic and M&A making up the balance. Although no figure for R&D is given for Q1, 2015 saw investment of €41.9m with 947 people working in R&D to develop new and improved products. Emphasis was given to R&D on innovative mobile payment solutions.

Wirecard's guidance for full year 2016 is for EBITDA of €290-310m which, at the mid-point, is 21% up on four times the Q1 EBITDA. That implies strong continuing growth in the remaining three quarters of this year.

The Q1 operational highlights included the UK launch of boon as the first fully digitised mobile payment solution within Apple Pay. And the Reserve Bank of India gave Wirecard's subsidiary, GI Technology, a Money Transfer Service Scheme (MTSS) licence enabling it to carry out inward remittances. Then Wirecard became the first non-financial institution to issue Visa prepaid cards in Singapore. Finally, Wirecard and T-Systems are supporting retailers in digitising their point-of-sale (POS) systems with a Wirecard platform providing value-added services at the POS.

CEO Markus Braun commented: "We differentiate ourselves from the competition through future-oriented internet-based technology services combined with long-standing banking expertise". MarketWatch gives a mean consensus estimate of 2016 eps as €1.72 with €2.12 for 2017. At yesterday's closing price of €39.8, that gives a 2017 P/E of 18.8 with an attractive PEG of 0.8. MarketWatch gives an average target price of €51.8.

Mega-engineering company AVEVA might become takeover target...

AVEVA's results for the year to end March were a mixture of good and bad news. The good news is that the board is "confident that we can achieve our targets in the current financial year and over the medium term". The bad news includes exceptional charges of £15.2m – mainly for professional fees for the aborted Schneider Electric transaction (£10.5m) and restructuring costs (£4.5m) for office rationalisation and headcount reduction in areas of reduced demand such as oil & gas.

The highlights of the results are:

- Revenue **down 3%** to £201.5m but the second half with revenue of £119.5m was much stronger than the first (H1 revenue was £85m).
- R&D down 1.7% to £32.1m but very high at **over 15.9%** of sales.
- Adjusted pre-tax profit **down 18%** to £51.2m (adjustments remove amortisation of intangibles, share-based payments and exceptionals). Unadjusted pre-tax profit of £29.4m.
- Adjusted basic eps **down 17%** to 62.04p (unadjusted of 32.03p).
- Final dividend per share **up 20%** to 30p making 36p for the year.
- Cash pile **up 4%** to £107.9m.

There are three strong points about these results. The first is recurring revenue at a high 76% of total revenue – a key plus for any software company and a testament to AVEVA's strong customer relationships. The second is the increased cash pile, which equates to 169p per share and gives the firepower for strategic acquisitions. The third is the high R&D investment as a proportion of sales, which ensures a continuing flow of new and improved products. R&D was not reduced significantly despite the drop in profits – a sign of a well-managed technology company.

The 20% increase in the final dividend signals the board's confidence in its outlook. It sees growth from four market areas: owner operators; the sale of additional software tools to existing 3D customers; broadening the range of markets served beyond oil & gas, power and marine; and further development of software-as-a-service.

In the last ten days we've had news of further AVEVA contract wins such as with DowAksa of Turkey, which has standardised on AVEVA's Integrated Engineering & Design (IE&D) solution. Also in Turkey, Technovision – the engineering subsidiary of Turkey's EPC contractor – has just implemented AVEVA's IE&D. And Omnix International has formed a formal business partnership with AVEVA dedicated to KSA (Saudi Arabia), Kuwait and Qatar Oil & Gas. Omnix, which has 25 years' experience in the region, will offer AVEVA's solutions to its customers using a dedicated team of AVEVA specialists that it is building up for that purpose. Jayant Deshpande, director of Omnix, commented on the opportunities in the region saying, "Kuwait alone is expected to award nearly $35bn of contracts before the year end".

Despite the increase in the dividend and the optimistic outlook, the shares were down 4.6% on Tuesday because adjusted eps was slightly (1.7%) below expectations. Some investors might also have hoped there would be a special dividend paid from the cash pile, rather like the 147p special paid in 2013. However, it looks as if management is keeping its cash as firepower for an acquisition. A bolt-on acquisition that earns a decent return on capital is preferable to another special dividend. However, investors seemed to have looked through these shorter-term issues to the medium-term potential yesterday so the shares rose 3.3%.

The consensus eps for 2017 is 66.4p so, at yesterday's close of 1,577p, the P/E for the business alone (excluding the cash of 169p/share) is 21.2 – which is reasonable for a company of AVEVA's quality and prospects. The increased dividend of 36p gives a yield of 2.3% (or 2.5% if you bought at recommendation). And there is the possibility of a bid from Emerson, GE, Siemens, Dassault Systèmes, and Aspen Technology (see issue #327); remember that the shares were over 2,200p when the Schneider bid looked as if it would be successful.

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