Client: Chi Med
Source: Shares (Main)
Date: 23 December 2010
Page: 11,12,14,15,16....
Reach: 13190
Size: 5846cm2
Value: 50977.12

Upbeat outlook

As in each of the last three years, the *Shares* journalists have come up with their very best large cap, mid cap and small cap ideas. A quick glance at the 18 names in the table below reveals five key investment themes.

The first and key idea is economic recovery. This immediately explains our positive view on giant media agency **WPP (WPP)** for one, since sales at chief executive officer (CEO) Martin Sorrell's firm appear to track gross domestic product (GDP) growth very closely. Margin expansion and operational gearing will take care of the rest, as a best-case scenario suggests earnings per share could jump by 68% between 2010 and 2013. Engineering components supplier **Brammer (BRAM)** is also well placed to benefit from an economic upturn, as firms look to stay lean and mean so they in turn can wring out maximum profits from increases in sales.

Second, our ongoing faith in the risk trade means we like emerging markets. Investment group **City of London Investment (CLIG)** looks a like a good play, not least as assets under management continue to rise. This is a product of both rising markets but also capital flows, as cash floods from West to East in search of superior economic growth and better investment returns. A riskier play, but potentially even more rewarding one, is **Steppe Cement (STCM:AIM)**, a leading building materials supplier in oil-rich Kazakhstan. Petrodollars are sloshing in to the country, helping the government to fund huge infrastructure projects. With a 20% share of the domestic cement market £82 million cap Steppe looks well positioned.

Third, we remain bullish on certain key commodities, notably gold and oil. In the precious metals space, three large gold mines in Greece and Romania attract us to **European Goldfields (EGU:AIM)** as a large cap pick. More speculatively **Triple Plate Junction (TPJ:AIM)** looks the best of all the mining minnows because of its project locations and partnerships with three of the world's biggest miners, all looking for multi-million ounce gold deposits. As for oil, we like FTSE 100 firm **Tullow Oil (TLW)** for its programme of high-impact drilling in West Africa and South America, while farm-in deals on **Chariot Oil & Gas' (CHAR:AIM)** massive acreage position offshore Namibia could be the catalyst for a re-rating. Such deals would add credibility to Chariot's estimates its Namibian acreage equates to a ten billion barrel resource and give the £270 million cap explorer a huge boost.

A fourth theme to emerge from our picks is that we have selected a number of firms where a new strategy, restructuring programme or management change should give fresh impetus to earnings and the share price alike. Jeweller **Theo Fennell (TFL:AIM)** has been revived by the reappointment of Barbara Snoad as CEO, while retailer **Majestic Wine (MJW:AIM)** has laid the foundations for rapid earnings progress under its boss Steve Lewis via a new minimum order strategy, physical expansion and a choice acquisition. **BP (BP.)** is taken to bounce back from a horrible 2010 under Bob Dudley, especially as his ongoing disposal programme is expected to outline how much hidden value lies within the oil major. BP's new honcho is also likely to return his charge to the dividend list. Increased shareholder payouts at **Vodafone (VOD)** should also boost market faith in its CEO Vittorio Colao who has a plan to refine the mobile telco's assets.

Finally, we have selected three healthcare plays. It may seem odd to choose such apparently defensive names when we are so bullish, yet a little portfolio diversification never did any harm. Moreover, each of **Hutchison China Meditech (HCM:AIM)**, **GW Pharmaceuticals (GWP:AIM)** and FTSE 100 stalwart **GlaxoSmithKline (GSK)** all seem capable of providing positive earnings surprises.

THE WRITER HAS EXPOSURE TO GOLD VIA ETFS PHYSICAL GOLD (PHAU) AND RBS STERLING HEDGED BULLION TRACKER (RBB1).

Shares' Tips for 2011

Stock	EPIC	Rating	Index	Sector	Market cap	Share price (p)
LARGE CAPS (over £500 million)						
BP	BP.	Buy	FTSE 100	Oil & Gas Producers	£89.2 billion	474p
European Goldfields	EGU:AIM	Buy	FTSE Aim 100	Mining	£1.6 billion	895p
GlaxoSmithKline	GSK	Buy	FTSE 100	Pharmaceuticals & Biotech	£65.0 billion	£12.55p
Tullow Oil	TLW	Buy	FTSE 100	Oil & Gas Producers	£10.9 billion	£12.36p
Vodafone	VOD	Buy	FTSE 100	Mobile Telecommunications	£88.7 billion	169.5p
WPP	WPP	Buy	FTSE 100	Media	£9.7 billion	766.5p
MID CAPS (£100 million to £499 million)						
Brammer	BRAM	Buy	FTSE SmallCap	Support Services	£244 million	230p
Chariot Oil & Gas	CHAR:AIM	Buy	FTSE AIM 100	Oil & Gas Producers	£270 million	187p
City of London Investment	CLIG	Buy		Financial Services	£120.3 million	458p
GW Pharmaceuticals	GWP:AIM	Buy	FTSE Aim UK 50	Pharmaceuticals & Biotech	£144 million	110p
Hutchison China Meditech	HCM:AIM	Buy		Pharmaceuticals & Biotech	£259.5 million	501p
Majestic Wine	MJW:AIM	Buy	FTSE Aim UK 50	General Retailers	£247 million	398.25p
SMALL CAPS (up to £99 million)						
Chaarat Gold	CGH:AIM	Buy	FTSE Aim All-Share	Mining	£97 million	72.5p
Parseq	PSQ:AIM	Buy	FTSE Aim All-Share	Software & Computer Services	£32 million	7.5p
Quercus Publishing	QUPP:PLUS	Buy		Media	£14.5 million	138p
Steppe Cement	STCM:AIM	Buy	FTSE Aim All-Share	Construction & Materials	£82.3 million	46p
Theo Fennell	TFL:AIM	Buy	FTSE Aim All-Share	Personal Goods	£11.5 million	50.5p
Triple Plate Junction	TPJ:AIM	Buy	FTSE Aim All-Share	Mining	£13.9 million	4.78p

Client: Chi Med
Source: Shares (Main)
Date: 23 December 2010
Page: 11,12,14,15,16....
Reach: 13190
Size: 5846cm2
Value: 50977.12

➔

York investor conference in early December that Verizon Wireless was generating so much cash 'you could not spend it all'. More importantly he admitted the mobile operation was 'paying down its debt,' adding it was 'fair to say that we should have a discussion in 2011 about what happens in 2012 and 2013'. This public shift in stance should lead to an agreement to restore dividends in 2012 and thus justify Sarin's refusal to consider its sale. An agreement to resume dividends should boost sentiment towards Vodafone, not least because of the benefits to cash. Although Vodafone's share of the free cashflow from SFR and Verizon Wireless in 2009-10 was £5 billion from an accounting point of view it only received £1 billion in actual readies.

The plan unveiled by Colao targeted organic revenue growth of 1% to 4%, free cashflow of £6.7 billion and maintained EBITDA margins for this year. In emerging markets such as South Africa, Turkey and India the group will benefit from increased mobile penetration. In mature areas such as Western Europe increased interest in mobile data should generate growth.

Vodafone itself has promised it will increase dividends by at least 7% a year. This implies a payout of at least 10.2p in 2012-13, for a juicy 6.0% yield. (JM)

THE WRITER HOLDS SHARES IN THIS COMPANY

from Western Europe and a third from Asia Pacific, South America, Africa and the Middle East and Central and Eastern Europe. With such a geographic spread, the FTSE 100 firm is likely to become a progressively better tracker of the world economy.

WPP is arguably better positioned ahead of this cycle than it was the last following the acquisition in the interim of Taylor Nelson Sofres, whose strength was research versus WPP's media buying. *Shares* believes research will be the winning marketing communications, or 'marcoms' stream. Research tends to be a higher margin business than media buying, which is a commodity operation subject to fierce competition. The highly cash generative WPP should also be able to make further acquisitions as it takes advantage of the lowly valuations that persist in the sector. (SK)

MID CAPS

Brammer (BRAM) 230p

Stop Loss: 184p

Pan-European engineering components supplier **Brammer (BRAM)** is enjoying strong market conditions and stands to have a fantastic 2011, where we predict earnings upgrades from analysts and further gains in the share price. Buy at 230p as revenue is being driven by the desire for large businesses to have more efficient operations, thereby calling up Brammer for its expertise in suggesting the best products and processes.

Companies around the world have learned an important lesson from the economic downturn since 2008. They cannot afford to have any fat on their business – namely idle assets, inefficient processes or other ways in which money is being wasted. This is creating an opportunity for Brammer to use its expertise in the engineering market to advise on ways to save money, ultimately resulting in product sales.

Its main area of business is the distribution of parts to run factory lines – such as bearings, gearboxes and pneumatics. It predominantly serves defensive industries including food and beverages, pharmaceuticals and utilities; in addition to other sectors including packaging and petroleum. Most of its end-markets are trading well in the current environment, including automotive where in Germany there is a boom in car production.

Brammer's latest update (18 Nov) said the company is trading ahead of expectations amid improving business conditions and market share gains.

Since the end of the half-year in June, the Manchester-headquartered firm has won five new pan-European 'Key Accounts' with potential annual revenues in excess of £30 million. That takes the total number of Key Account wins to 12 since the start of 2010, against seven in 2009. Such relationships see Brammer take, or assume it will take, management control of a company's stock.

Brammer is not simply represented by a catalogue of spare parts used by engineers when a component breaks or factory line grinds to a halt. It is pro-actively involved in industrial businesses, from replacing multiple suppliers so clients only get a handful of invoices each month and deal with a single company, rather than having a multitude of paperwork from hundreds of different parties – to assessing how factories are run, applying its product skills and in-depth knowledge of processes. This has resulted in strong client relationships where Brammer has impressed by making one site efficient and subsequently won subsequent business in other sites – often in multiple countries.

Market consensus forecasts reckon Brammer will see 45% pre-tax profit growth in 2010 to £20 million and a further 30% leap to £25.9 million in 2011. Stockbroker Investec has a 260p price target, implying 13% upside. We reckon this price target is far too conservative and will soon be smashed. (DC)

COMPANY DETAILS

Sector: Support services
Sub-sector: Industrial suppliers
Businesses: Engineering components distributor

Market value: £244 million
PE Dec 2010: 17.6
PE Dec 2011: 13.6
1-year relative strength: 73.2%
Prospective dividend yield: 2.5%
Bid/offer spread: 0.7%

Client: Chi Med
Source: Shares (Main)
Date: 23 December 2010
Page: 11,12,14,15,16....
Reach: 13190
Size: 5846cm2
Value: 50977.12

➔

Chariot Oil & Gas (CHAR:AIM) 187p

Stop loss: 149.6p

The likely announcement of one or more farm-in deals on **Chariot Oil & Gas' (CHAR:AIM)** massive acreage position offshore Namibia - expected early in the first quarter - is a potentially significant catalyst. *Shares* would expect a general appreciation in the share price ahead of a planned exploration well at the end of 2011.

Results from the first well are unlikely until 2012. Investors could therefore see significant gains next year off the back of any agreement and the subsequent contracting of a rig, without the need for any direct exposure to the risks involved in drilling for oil.

Chariot has a 30,000 kilometre position off the coast of the West African country. An independent report from respected industry consultants Netherland Sewell puts the resource potential of this acreage at ten billion barrels of oil.

A farm-in agreement would add credibility to this estimate. Very strong industry interest in the licences suggests Chariot has a good chance of securing a deal with a high-quality partner on attractive terms. The company announced alongside interim results in November (4 Nov) it had been forced to open a second data room and extend the farm-out process because of the sheer volume of demand.

Namibia has seen limited exploration activity in the past, with a total of nine exploration wells in its offshore territory to date. It is an extensive region, similar in size to the North Sea, and its geological history is thought to be similar to that of the coastline of Brazil, where **Petrobras (PETR3.SA)** and its partner **BG (BG.)** have a made a number of exciting discoveries in recent years. Brazilian state-owned giant Petrobras farmed in for 50% of one of Chariot's six Namibian licences in May 2009 suggesting it, at least, saw similarities between the two regions.

Chariot's licences are equally split across three distinct areas: the 100%-owned northern blocks in the Namibe basin; the wholly owned central blocks, which lie across the Luderitz and Walvis basins; and two southern blocks, in the Orange basin, the northernmost of which is half-owned by Petrobras.

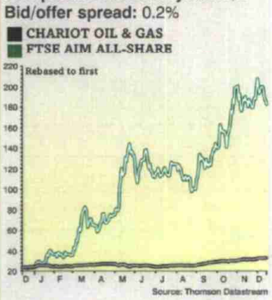
Immediately to the south of the southern blocks lies the Kudu gas discovery, estimated to contain up to one trillion feet (tcf) of gas. It became the first major discovery offshore Namibia way back in 1974.

Chariot had $13.4 million of cash on its balance sheet at the end of August. This looks sufficient to fund its ongoing administrative costs of around $3.5 million per year. (TS)

COMPANY DETAILS

Sector: Oil & Gas Producers
Sub-sector: Exploration & Production
Business: 'Pure' exploration in Namibia

Market value: £270 million
PE 2011: n/a
PE 2012: n/a
1-year relative strength: +612.0%
Prospective dividend yield: n/a
Bid/offer spread: 0.2%



City of London Investment (CLIG) 458p

Stop loss: 366.4p

Fund manager **City of London Investment (CLIG)** invests in emerging markets via investment trusts and should be the beneficiary of both increasing appetite from its clients for risk assets and rising equity indices. The latter is the outcome of capital flow from West to East as investors go in search of higher returns, especially as interest rates remain at ultra-low levels in developed nations.

The £120 million cap has put in a very strong performance in the year to date with a 36.3% outperformance of the FTSE All-Share. This easily outstrips a 9.5% increase in the key emerging markets benchmark MSCI Emerging Markets. A prospective price/earnings ratio of 13.3 times and a juicy 5.1% yield both suggest there is more to go for even after this year's good showing.

The emerging markets surge that lies ahead may even surpass the one seen in the early 1990s. The MSCI Emerging Markets index rose from 3,188.8 in September 1992, when the US Federal Reserve took the Fed Funds rates down to their 3% low point of that cycle, to 12,353.1 by April 1994 – a stunning 287% advance. This time around Fed Funds have bottomed at 0.25% with monetary loosening further supplemented by quantitative easing (QE).

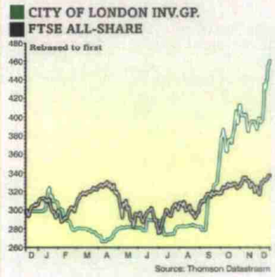
This month's (6 Dec) trading update, for the interim period ending 30 November, revealed a 17% increase in assets under management in the space of three months, from $4.7 billion to $5.5 billion. This growth was due both further advances in the MSCI benchmark and healthy fund inflows.

Chief executive officer and founder Barry Olliff has started to sell down his stake over the past year but since he began his disposals at 310p, this has hardly held the shares back. He still owns a 15.5% stake although intends to pitch out 500,000 shares at the 450p and 500p levels respectively. As has been seen with other founding directors selling down their stakes at firms such as **Abcam (ABC:AIM)**, this can be a positive if there are willing institutional investors ready to take on the stock as the net effect will be further improved liquidity. (SK)

COMPANY DETAILS

Sector: Financial Services
Sub-sector: Asset Managers
Business: Emerging markets fund manager

Market value: £120.3 million
PE 2011: 13.3
PE 2012: 11.2
1-year relative strength: +36.3%
Prospective dividend yield: 5.1%
Bid/offer spread: 1.45%



➔

Client: Chi Med
Source: Shares (Main)
Date: 23 December 2010
Page: 11,12,14,15,16....
Reach: 13190
Size: 5846cm2
Value: 50977.12

Citigate Dewe Rogerson

➔

GW Pharmaceuticals
(GWP:AIM) 110p

Stop loss: 88p

A specialty pharma company that develops cannabis-based drugs for substantial, niche markets with hitherto unmet needs, **GW Pharmaceuticals (GWP:AIM)** has a net cash balance sheet, strong products and huge potential.

The Salisbury-headquartered firm's strategy of commercialising its drugs pipeline appears to be working. Its lead product, Sativex, has successfully cleared regulatory hurdles in the UK, Spain, Canada and New Zealand as treatment for spasticity due to multiple sclerosis (MS). The UK launch will be followed by entry into Spain early next year, then Germany in the second half of 2011. It should find a ready market as there are a potential 1.2 million MS patients worldwide, 82% of whom suffer from spasticity. Moreover, there is dissatisfaction with current treatments.

Sativex has also also entered the first part of Phase III trials in the USA for the treatment of cancer pain. It is intended for use alongside existing treatments to help terminally ill patients. The cost of the trials are being borne by **Otsuka (4758.T)**, a Japanese pharmaceutical company, which has licensed the US commercialisation rights to the product.

Regulatory success with Sativex validates GW's cannabinoid technology platform. Ongoing approvals and market launches for the product around the world should help drive up earnings in the medium term. Yet this represents but a small fraction of the commercial potential latent in cannabinoid drugs. GW has also made progress in developing its early-stage cannabinoid pipeline and in June extended a three-year research collaboration agreement with Otsuka, which itself has links with American drug giant **Bristol Myers-Squibb (BMY:NYSE)**. GW will receive $12 million to fund the investigation of products for cancer and central nervous system disorders over that period.

For the year ending 30 September 2010 GW reported a pre-tax profit of £4.6 million on revenues of £30.6 million, comfortably ahead of the previous year's £1m profit on turnover of £24 million.

Despite the great strategic progress, profits may well fall in the short term as the £144 million cap experiences a lag between further milestone payments from partners and increased sales of Sativex. Yet as Paul Cuddon, an analyst with house broker Peel Hunt, points out: 'The bigger picture here is that GW Pharma has effectively de-risked its cannabinoid platform and is intent on achieving global roll-out of a whole pipeline of drugs.'

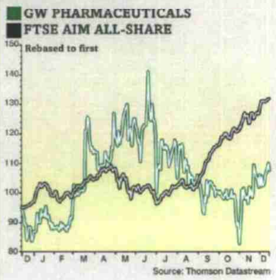
He forecasts a small pre-tax loss in 2011 of £700,000 followed by a deficit of £2.6 million in 2012 before sales of Sativex and further development of its pipeline move it into sustained profitability around 2013. A year-end cash balance of £25.2 million means GW should have no problem in absorbing these initial losses as it develops its cannabinoid pipeline and global sales of Sativex.

Cuddon has a twelve-month price target of 160p, for 50% potential upside. (CM)

COMPANY DETAILS

Sector: Pharmaceuticals and Biotechnology
Sub-sector: Pharmaceuticals
Business: Specialty pharmaceuticals

Market value: £144 million
PE 2011: n/a
PE 2012: n/a
1-year relative strength: +6.7%
Prospective dividend yield: n/a
Bid/offer spread: 3.8%



Hutchison China Meditech
(HCM:AIM) 501p

Stop loss: 401p

Booming profits from a traditional Chinese medicine (TCM) arm are being held back by start-up losses at two other units. But they have equally huge potential and as the early-stage deficits diminish **Hutchison China Meditech (HCM:AIM)** will unveil powerful earnings momentum and establish itself as a true growth stock.

Hutchison has three complementary businesses, all of which have excellent long-term potential.

First, it seeks to develop and commercialise drugs approved for the Western markets, based on its knowledge of TCM via its MediPharma unit. Lead drug HMPL-004 has already passed Phase IIb trials for ulcerative colitis, while strong relationships with **Eli Lilly (LLY:NYSE)** and **Johnson & Johnson (JNJ:NYSE)** subsidiary Ortho-McNeil-Janssen should help the pipeline develop. MediPharma is loss-making but November's investment in the operation by Japan's Mitsui gives the

Majestic Wine
(MJW:AIM) 398.25p

Stop loss: 318.6p

A change in minimum order size, physical expansion and a choice acquisition mean **Majestic Wine (MJW:AIM)** can continue to thrive despite a difficult retail environment.

Shares has frequently praised Majestic's business model, which sees the firm offer a wide choice at competitive prices. This service is compounded by having knowledgeable staff who can advise the average consumer.

Although the Watford-headquartered firm's recent success has also been helped by the demise of the rival Thresher chain, three decisions made by chief executive officer Steve Lewis since his appointment in 2008 have also made a huge difference.

First, Majestic decided in September 2009 to reduce its minimum order size from 12 bottles to six. This created a new market and helped stimulate both a 14% increase in the number of active customers to 496,000 and 7.6% like-for-like sales (LFL) growth in the first half of the fiscal year.

➔

Client: Chi Med
Source: Shares (Main)
Date: 23 December 2010
Page: 11,12,14,15,16....
Reach: 13190
Size: 5846cm2
Value: 50977.12

➔

business an implicit value of $102 million, or 122p a share.

Second, Chi-Med addresses the Chinese healthcare market, which again focuses heavily on TCM. Its brands and distribution network are strong and underlying demand excellent. This unit should also receive a major boost from September's launch of infant nutrition products, notably baby milk. After a spate of scandals in the country in the area of food safety and milk in particular, this market should be ready to really take off. Such is the interest, the Hong Kong market has seen three flotations by baby milk firms in the second half of this year: **China Modern Dairy (1117:HK)**, **China Mengniu Dairy (2319:HK)** and **Yashili International (1230:HK)**.

Finally Chi-Med has a thriving consumer products division as the £260 million cap plans to tap in to the organic foods market, offering competitively priced products.

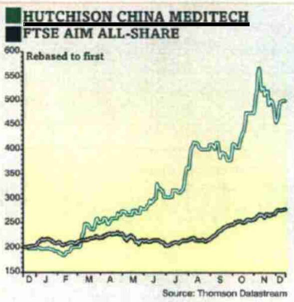
A maiden pre-tax profit is expected in 2011 as sales continue to rocket. Admittedly, income of £1.7 million looks tiny relative to the £260 million market cap but this should just be the beginning as the start-up losses at MediPharma and in organic foods drop away and the Chinese consumer healthcare market continues to grow in excess of 15% a year.

Liquidity in the stock is not great as mighty conglomerate **Hutchison Whampoa (0013.HK)** holds 70.9% of the shares and Slater Investments a further 10% across two funds. But the prospect of further marked capital appreciation should mean this is only a minor irritant, not least as a bid/offer spread of 2.6% is perfectly workable. (RM)

COMPANY DETAILS

Sector: Pharmaceuticals & Biotechnology
Sub-sector: Pharmaceuticals
Business: Drugs manufactor

Market Value: £259.5 million
PE 2011: n/a
PE 2012: n/a
1-year relative strength: +120.1%
Prospective dividend yield: n/a
Bid/offer spread: 2.6%



Second, Lewis decided to accelerate the pace of expansion. Under his predecessor the company was opening five to six stores a year. Majestic is taking advantage of the weaker property market to accelerate the pace of openings to between ten and 12 a year. The CEO has laid out a medium-term target of 250 stores, an increase of over 55% on the present estate of 160 outlets. We suspect this target will be increased still further and provide a strong platform for group earnings growth.

Finally, the £247 million cap bought Lay & Wheeler in March 2009. The target had not been especially well managed so a lot of cost could be quickly stripped out. In addition, it has enjoyed considerable success in selling 'en primeur' wine from the exceptional 2009 Bordeaux vintage. Majestic has reported deferred profits of £2.2 million from Lay & Wheeler on sales of £13.5 million

Elsewhere, Wine & Beer World, the firm's French business, has benefited from the decision by other UK retailers to desert Calais. As a result it enjoyed 22% LFL growth in the first half, according to November's interim figures.

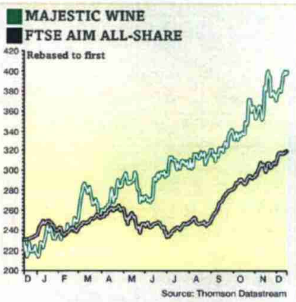
Although the shares are selling on a demanding rating of 18.4 times earnings for 2011, we believe there is scope for further earnings forecast upgrades. Meanwhile the emphasis upon physical expansion should underwrite several years of strong profits growth, a prospect shared by few medium-sized retailers. (JM)

THE WRITER HOLDS SHARES IN THIS COMPANY

COMPANY DETAILS

Sector: General retailers
Sub-sector: Specialty retailers
Business: Retailing wines, beer and spirits.

Market Value: £247 million
PE 2011: 18.4
PE 2012: 16.5
1-year relative strength: +58.3%
Prospective dividend yield: 3.5%
Bid/offer spread: 0.82%



➔