THE UK SHAREHOLDERS' ASSOCIATION INVESTIGATES AIM COMPANIES' ANNUAL REPORTS

JAMES HALSTEAD PLC – Number 6 in the Investors Chronicle 'AIM 100', April 2016

Annual Report for year ended 30 June 2016

INTRODUCTION

James Halstead is a successful, family run flooring manufacturer, established in 1913. The product range is almost entirely solid flooring, although it includes carpet tiles but not carpeting. Markets are principally office, retail and industrial. Sales over the last 10 years have increased at a compound rate of 5.75%pa to reach £226m (62½% overseas) with operating profits before tax rising by 7.75%pa to £45.5m. The operating return on Shareholders' Equity (plus a Pension Deficit; see below) is over 38% with excellent cash flow and an attractive dividend.

The market recognizes the company's strengths, with a market capitalization of £1bn, an historic p/e ratio of 29.7 and a yield of 2.4%.

THE REPORT

The first sign of how the company regards shareholders was the speed of response to a request for hard copy of the accounts; an email was sent at 12.20pm on 19 December and the copy was delivered by first class post on 21 December.

There are 64 pages, including covers, with 9 pages taken up by the Company accounts. Except for the front cover, there are no photos and there is no marketing blurb. The text is terse and to the point, with the Chairman taking one page which includes a clear statement of Strategy which is *"….totally flooring focused…..designed to increase revenue which then creates wealth for our shareholders in the form of a dividend….It also underpins job security for our employees and benefits all stakeholders in the business".*

The Chief Executive has three pages and gives a clear review of performance across the defined geographical sectors (see below).

The Finance Director (FD) follows his colleagues by giving an informative review, including Risks and an analysis of the Defined Benefit Pension Scheme deficit; the scheme was closed in 2002. Rather than have Key Performance Indicators (KPIs), the Board concentrates on sound management of its subsidiaries to achieve short and long term growth in profits and dividends plus control of working capital. The FD goes on to say *"Risk comes from not knowing what you are doing"* and, by understanding the business, *"risk is ameliorated but not eliminated".* The Group hedges known and forecast exchange rate exposure on sales and purchases. The effect of exchange rates on overseas assets and profits is reported in the accounts and, over the last five years, these effects have been modest. Of more financial significance is that the Pension Scheme shows an actuarial balance sheet liability of £25.4m before deferred tax of £4.3m. The Board takes a long term view of this liability in relation to interest rates and to the Group's cash flow and market capitalisation. With £44m of cash on the balance sheet the Company is well placed to cover the liability promptly if it has to.

The Directors' Report plus those on Remuneration and Corporate Governance take up six pages.

THE DIVISIONS

One of the less satisfactory aspects of the report is the shortage of information in some areas. For example, we are given very little information on the product range, nor are we told whether there are any overseas manufacturing facilities or whether the group sources any manufactured goods from third parties. We are given the Directors names, but get no biographical details. Unfortunately, the web site is not much more forthcoming except that there is a map of the world showing where the Group is represented and the directors' photos appear with a brief biography. What the web site does reveal is that there is a subsidiary, Phoenix, selling helmets and other motorcycle products; this is not mentioned in the report except that Phoenix is listed as being dormant. Odd, to say the least; even if this is somebody's hobby it deserves a mention in the report.

Turning to what we are told, sales (but not profits) are split into four segments, UK (37½%), Europe (40¼%), Australasia/Asia (15%) and Rest (7¼%). Referring to the web site, apart from Canada, there does not appear to be any representation in the Americas.

It would seem that the Group's manufacturing facilities are in the UK and goods are shipped to warehouses at the locations shown on the web site, where finishing processes can be carried out. Since a significant part of the business is on contracts, this gives some forward visibility. Inventory at £62.8m suggests a total stock turn of 3.6 times. The majority of inventory is accounted for by finished goods (£58.2m) so managing stocks must be a key issue in controlling working capital, meeting market demands and avoiding wastage. The Chief Executive reports discontinued stock as being less than 2% of inventory, which is good going.

ACCOUNTS

The operating profit of £45.5m gives a 20% return on sales. However, because of tax, the pension scheme charge for the year (£7.4m) and the generous dividend, there is an £11.9m deficit on retained earnings.

Non-current assets comprise tangibles (£37.6m), goodwill (£3.2m) and a deferred tax credit (£5.1m, mainly relating to the pension scheme deficit). Tangibles are freehold property (£19.1m) and plant/equipment (£15.3m). It is interesting to note that plant/equipment is depreciated over periods varying from 2 to 20 years. This doesn't give much away except by looking at cost, £67.0m, which, with additions net of depreciation at only slightly over £1m pa, suggests that the equipment may be fairly elderly.

The gross pension scheme deficit of £25.4 is included in non-current liabilities but, in calculating operating return on equity, the FD adds back the deficit (net of deferred tax) to balance sheet equity of £97.5m to give a more cautious and realistic return of 38%.

The balance sheet looks very strong with a high level of liquidity; cash and debtors come to almost £78m against current liabilities of just £26m of which £25m is the pension deficit referred to above. All in all, this is a very tidy set of figures.

DIRECTORS, EMPLOYEES & SHAREHOLDERS

There are 6 directors, all male. The non-executive Chairman, Geoffrey Halstead, has been with the Group for many years and was CE for an unstated period, until he handed over to Mark Halstead in 2002. The FD joined the Group in 1989 and took up his present role in 1999. The other executive director is responsible for Europe and ran the German division before joining the board in 2008. The other 2 (non-exec) directors joined in 2001 and 2012 and have strong associations with the North-West.

The directors have a 10.6% beneficial interest in the equity (principally the Halsteads) and three act as Trustees for a stated 11.7% - which latter figure must be treated with caution as there could be a large element of double counting between the three Trustees. Also, the trust holdings are almost certain to be included in the major shareholders, the John Halstead Settlement (17.1%), Rulegale Nominees (16.4%) and Vidacos Nominees (3.2%).

We are not told the directors' emoluments except in the notes, where they appear as an aggregate figure of £1.8m, including bonuses of £0.8m. There are no directors' share schemes.

There were 833 employees earning £41.7k each, both figures being averages for the year. There is a modest employee share scheme funded from profits of the subsidiaries.

SUMMARY

A successful, tightly run family controlled company where shareholders really count. Your reviewer was born near their head office and appreciates the direct Lancastrian style of the document. However, there is scope between the report and the web site for giving shareholders, actual and potential, more information about the business without giving anything away to competitors. We would also like to see female representation on the Board.

HPB 10/01/2017