THE EQUITY RATING GAME

OUR GUEST WRITER LOOKS AT FOUR STOCKS WHICH HE BELIEVES ARE EITHER UNDER-VALUED OR OVER-VALUED BY THE MARKET

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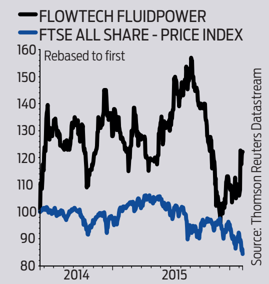
The small cap universe, and its somewhat erratic liquidity, regularly throws up valuation anomalies. Favoured stocks can see their share prices pushed ever higher to potentially unsustainable levels and the unloved find it increasingly hard to attract any interest, whatever the perceived valuation attractions.

The following small caps offer food for thought in this respect, with dramatically different valuations.

UNDER-RATED: **FLOWTECH FLUIDPOWER (FLO:AIM)** 122.25P

Flowtech Fluidpower is specialist supplier of technical fluid power products with distribution facilities in the UK and Benelux. With a current market capitalisation of £52 million, Flowtech offers an unrivalled range of products to over 3,600 distributors and resellers.

Its catalogue is the definitive source for fluid power products and contains approximately 52,000 individual product lines which are distributed to more than 85,000 industrial maintenance, repair and overhaul end users.



Since arriving on AIM in May 2014, the group has performed admirably at the operating level. Interim results for the six months to 30 June 2015 saw revenue rise 24.6% to £21.4 million and underlying operating profit up 3.8% % to £3.4 million.

A trading statement on 18 January 2016 confirms that revenue for the full year ending December 2015 was £44.7 million, an 18% year on year increase. It says margins, earnings and profitability are in line with expectations, being for pre-tax profit of £6.7 million.

A distribution business consistently generating operating margins of close to 15% with a free cash flow yield that is now over 10% is certainly doing quite a lot right. Its expansion strategy into hydraulics also appears to be developing nicely with acquisitions made at sensible prices that are set to repay themselves in quick time.

CHEAP VALUATION

While the shares got off to a positive start on AIM, they have subsequently found little support, falling back close to the 100p IPO (initial public offering) price. They now trade at a lowly 8.2 times forecast earnings for 2016 and yield 4.5%, with the dividend covered more than twice by forecast earnings per share.

The recent trading update should have dispelled the

doubters, when trading was confirmed to be in line with estimates and a commitment to a final dividend.

Net debt is modest and the balance sheet in decent shape with plenty of fire power to support further bolt-on acquisitions, which would see more product added to the group's distribution platform.

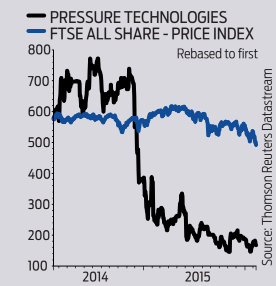
There might be some short term headwinds and the fluid power sector doesn't generate too much excitement but, as it has demonstrated over the past eight years through some challenging times, this little business should do very nicely over the long term.

UNDER-RATED: **PRESSURE TECHNOLOGIES (PRES:AIM)** 166.5P

It's easy to see why the market dislikes Pressure Technologies, the manufacturer of high pressure systems. Its past is firmly rooted in the world of offshore oil and gas as a supplier of key components to that industry.

Having expanded considerably over the past few years, the Sheffield-headquartered group now has four divisions: Precision Machined Components, Cylinders, Engineered Products and Alternative Energy. These serve four markets: oil and gas, defence, industrial gases and alternative energy.

Group revenue for the financial year ending 3 October 2015 was £55.6 million and adjusted operating profit was £3.3 million. Precision Machined Components was the biggest contributor to revenue (£18.8 million) and operating profit



(£4.5 million).

With oil price issues dominating, the shares trade at a modest 10.4 times forecast earnings for the current financial year. It has a 5.1% prospective dividend yield which is twice covered by forecast earnings per share.

UNDER THE RADAR

The market seems to be ignoring the considerable progress being made in the group's Alternative Energy division, something that was highlighted when it held a capital markets day (26 Jan) focusing on the market opportunity and business strategy for this expanding area of the business.

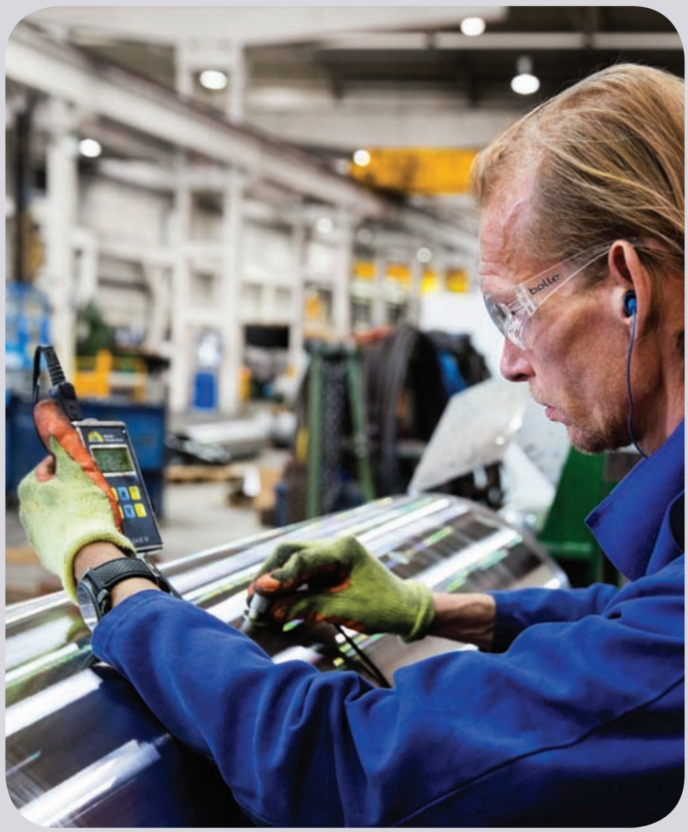
While the Alternative Energy division has contributed very little up to now (2015: revenue £14 million, operating loss £1.1 million), the purchase of assets from technology provider Greenlane in October 2014 has given the division a worldwide platform for selling biogas upgrading technology.

BIG OPPORTUNITY

There is significant potential for Biogas upgrading as a solution to waste management and renewable energy supply. Pressure Technologies has extended its technology to cover a wider range of solutions for this market which has plenty of growth potential, particularly in mainland Europe and North America.

France still leads Europe in agriculture infrastructure with approximately 730,000 farms and the vision of the French Environment and Energy Management Agency is to produce 70 TWh (terawatt hours) of biogas annually by 2030 with 50% of that injected into the grid.

There are more than 2,000 sites across the US already producing biogas with the potential for an additional 11,000 biogas systems. There are also plenty of incentives for biogas in the US as organic



material is banned from landfill sites in many US states, and price guarantees four times that of natural gas, with the state of California doubling this amount.

Greenlane has also had considerable success in Canada having provided upgrading equipment to the world's largest biomethane production plant in Montreal. The group has a presence in all the key markets with a total of 95 upgrading systems currently in operation and a support infrastructure in place.

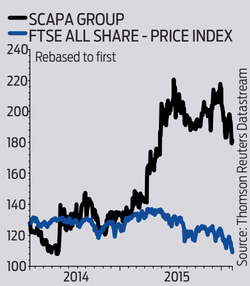
In the short term investors need to look beyond the negative sentiment surrounding the oil price and focus on the potential in Alternative Energy which appears to be considerable.

OVER-RATED: **SCAPA (SCPA:AIM)** 180P

Since being appointed chief executive of Scapa in November 2009, Heejae Chae has seen shares in the manufacturer of bonding solutions and adhesive components soar over 1,000% in value.

The business was evidently in a difficult spot when he arrived and has since made considerable progress. Nevertheless, it's a puzzle how Scapa has been able to maintain such a rich valuation weighed down as it is by several millstones.

The group has two distinct divisions, Healthcare and Industrial. Scapa Healthcare is a worldwide supplier of customised medical adhesive tapes, component materials and converted products for the medical device, wound care and hospital markets.



This division is the key attraction for investors and supports the relatively lofty valuation. For the six months to 30 September 2015, Scapa Healthcare saw revenue grow 21% to £43.4 million and trading profit rise 20% to £6.5 million, which means it now represents 65% of the group's total trading profit and operating margins of 15% highlighting the attractions.

According to management, the group's industrial strategy is one of 'maximising return on capital employed' addressing the key markets of automotive, cable, construction and specialty with its adhesive films and tapes.

For the six months ending 30 September 2015, Scapa Industrial revenue fell 3.8% to £75.9 million with trading profit up 13% to £5.1 million.

The past few years have seen some major re-structuring with much of the focus on expanding the Scapa Healthcare business. Cash flow has improved significantly with an operating cash inflow of £13.1 million in the financial year ending March 2015 and free cash flow of £5.6 million (pre-tax) following further significant capital investment.

PENSION PROBLEM

The group continues to be burdened with a sizeable pension deficit (£39.8 million at 31 March 2015) which demands cash payments of approximately £4 million per year. To put things into context, pension scheme liabilities of over £200 million should be compared with the current market capitalisation of £263 million.

Scapa is doing its best to shed the industrial baggage of old. There still seems to be plenty of work to do yet the shares trade at a seemingly full 17.8 times earnings estimates for the financial year ending March 2016, falling to 15.3 times for 2017, yielding just 1.1%. It's a puzzle how this is justified in the current climate.

'CRAWSHAW: A PER STORE VALUE OF OVER £1.5 MILLION SMACKS OF MADNESS IN THE VOLATILE WORLD OF RAW MEAT AND HOT COOKED FOOD'

OVER-RATED:
CRAWSHAW (CRAW:AIM) 78.5P

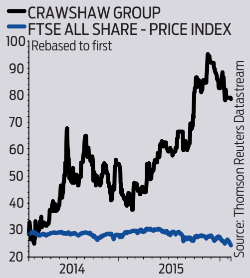
Crawshaw is an AIM-quoted chain of butcher shops providing a new and varied quality offering of both raw meat and hot cooked food.

At first glance a butcher is hardly the sort of stock to get the pulse racing (readers may remember the demise of Dewhurst in 1995) but the share price has risen over 7,000% since the horse meat scandal broke in January 2013.

The group currently has 22 retail outlets situated throughout Yorkshire, Lincolnshire, Nottinghamshire and Humberside and a processing and distribution centre in Rotherham, with plans to open another 17 stores in the current financial year ending January 2017.

Up to now it's been a terrific story, particularly for a number of private investors who were quick to recognise the potential back in 2013. However, it's an enigma how this small business, which operates in a highly competitive sector and is only beginning its journey of expansion, has a market capitalisation of more than £60 million.

For the six months to 31 July 2015, turnover rose just over 40% to £16.7 million and gross profit was up 44% to £7.5 million (gross margin 45%). The group registered an 'adjusted' pre-tax profit of £0.9 million, with 'adjustments' primarily in respect of 'accelerated opening costs.' Those adjustments are likely to be a significant feature of results going forward, rendering broker estimates relatively meaningless.



GETTING AHEAD OF EVENTS

Crawshaw has plenty of work still ahead of it and meaningful profit is several years away. It's therefore a puzzle how the market can justify such a heady valuation.

The projected 2016 year-end store portfolio of 39 sites already suggests a per store value of over £1.5 million which smacks of madness in the volatile world of raw meat and hot cooked food.

By comparison, Main Market-listed **Greggs (GRG)**, the highly regarded bakery food-on-the-go retailer, operates 1,698 shops and has a market capitalisation of £1 billion, implying a per store value of just under £600,000.

For the half year to 4 July 2015, Greggs had sales of £398 million (up 6.4%), generated gross profit of £246 million (gross margin 62%) and operating profit of £25.6 million.

Crawshaw may be a beneficiary of declining rental costs on the high street but as its footprint expands it could be harder to secure the desired sites and the competition may also up its game.

DISCLOSURE: Chris Boxall is joint chief executive of Fundamental Asset Management. Fundamental manages portfolios which hold shares in Flowtech Fluidpower and Pressure Technologies.