PILLING & CO
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Pilling's Nap Choices – Investment Room Tips for 2025

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Happy New Year to all our clients! To start off 2025, we've asked our investment committee members to share their top stock picks for the year ahead.

1. International Consolidated Airlines Group (IAG)

You may be more familiar with IAG through its national carriers, including British Airways. In recent years, IAG has faced increasing competition from budget airlines. However, the company responded by acquiring other carriers and focusing on financial discipline, often at the expense of passenger perks. Now, with volatility in fuel prices and new aircraft availability affecting budget carriers, IAG – which operates British Airways, Iberia, Aer Lingus, and Vueling – is poised for growth.

In 2024, IAG saw excellent financial performance and a strong share price, outperforming rivals like EasyJet, Lufthansa, and KLM. This success has been driven by the company's exposure to premium customers and higher fares, leading to better margins compared to low-cost operators like Ryanair. Additionally, IAG's long-haul network, especially in Latin America, continues to recover well, with its transatlantic flights via Heathrow expected to be a key driver for 2025.

The shares are attractively priced at a 5x P/E ratio, offering a 3% dividend yield and a 13% free cash flow earnings yield at the time of writing. Potential catalysts for a re-rating include possible re-inclusion in the MSCI index, further share buybacks, and continued growth in premium markets.

2. BAE Systems (BA.)

Given the growing global security concerns, as highlighted by recent warnings from UK and US intelligence services, it's a good time to revisit BAE Systems. The company is well-positioned with strong drivers both in the short and long term.

BAE's Maritime division and its armoured business in Sweden and the US represent around 33% of revenue and are seeing positive order visibility, particularly due to defence spending related to the war in Ukraine. Long-term projects such as the Global Combat Air fighter jets programme and the AUKUS submarine alliance also provide significant growth opportunities.

Additionally, BAE's diverse customer base, spanning both the US and European markets, should allow the company to benefit from increasing US military presence in Asia. The recent order of 12 Typhoon fighter jets by Qatar further underscores BAE's strong position in the global defence sector.

The shares are currently trading at a 17x P/E ratio with a 2.7% dividend yield, and BAE is actively buying back shares, signaling an attractive valuation.

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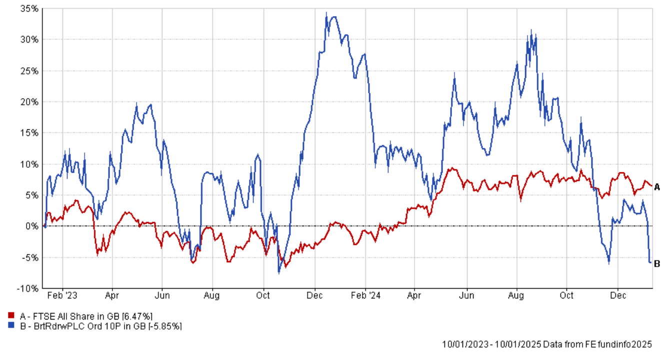
3. UK Housebuilders – not one but two ideas!

The housebuilding sector endured a challenging 2024, with share prices dropping by a third since August (excluding Vistry, which fell 45% due to several profit warnings). However, the UK government's recent National Planning Policy Framework aims to address the housing shortage by targeting 1.5 million new homes over the current parliament, with an annual target of 370,000 new homes. While this target may seem ambitious, it does create potential for sector recovery.



Broker Stifel notes that housebuilders are now priced at recessionary levels, with many stocks trading below book value. Despite headwinds such as labour shortages, high mortgage costs, and planning constraints, higher house prices and improved margins are expected. In fact, consensus is predicting a 2.9% increase in house prices this year, with mortgage rates expected to decrease over time, which should boost housing demand.

Notably, **Barratt Developments** and **Redrow (BTRW)** have merged into a new group with a strong land position and synergies from the merger could exceed market expectations. Their shares offer a dividend yield of 4%.

Meanwhile, **Taylor Wimpey (TW.)**, known for its quality landbank, provides a reliable dividend yield of 8.6%.

Both companies are currently trading below book value, reflecting the market's current cautious outlook.

4. Clarkson (CKN)

Clarkson is not just a shipping broker but a leader in shipping data, employing 225 experts who collect, analyse, and interpret data on routes, vessels, and trends. This data-driven approach has allowed Clarkson to dominate its market, holding a top position in every segment it operates in.

The company's expertise extends beyond logistics; Clarkson tailors solutions based on detailed insights into ships' conditions, maintenance, and other key variables. This makes them indispensable to clients in the maritime industry.

The global shipping industry is driven by factors like rising populations, growing economies, and international trade. Furthermore, years of underinvestment in shipping have led to a chronic shortage of ships, resulting in persistently higher freight rates.

Clarkson's strong earnings growth, robust cash conversion, and progressive dividend policy highlight its solid financial performance. The company recently reported results ahead of expectations, with strong profit growth forecasted. Clarkson shares are currently trading at a 13x P/E ratio and offer a 3% dividend yield.

We hope you find these insights helpful as you navigate the investment landscape in 2025. As always, our team is here to support your investment goals.