

## Holland Views – JD Wetherspoon (Price £4.26p; MCap £537m)

### A snowball on a really long hill..?

Many investors have a layman's view of JD Wetherspoon. Some will tell you that the pubs are dirty or that the beer is old and that is why it is cheap. Others will claim the business model is poor due to return on capital being low and falling. We have looked at this group very closely now and strongly contest all of these pre-conceived views. We believe we may have found another high quality UK consumer franchise with a wide and growing moat. This one charges industry smashing prices that others cannot match, but only has a 1.5% market share. As such we wonder if this is what a snowball at the top of long hill looks like?

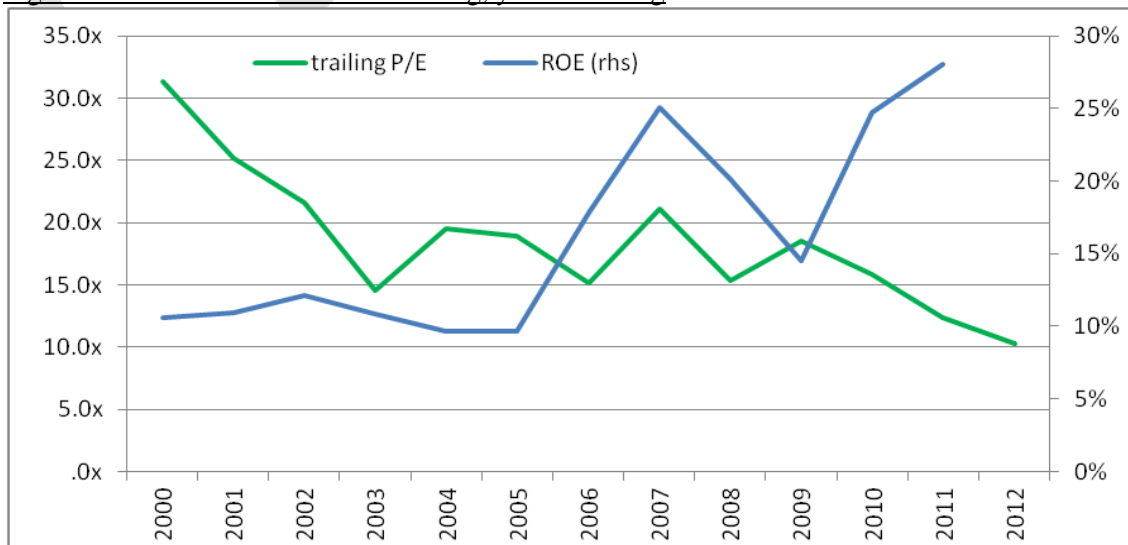
### Now it's even undercutting the British Legion

It is ironic that many of the UK retail businesses which we find most attractive as investments are often those which seem least likely to be frequented by City fund managers. To our list of often overlooked (and undervalued) retail franchises - which includes Next, Greggs, Albemarle & Bond, Tesco and Morrison - we now add pub chain JD Wetherspoon.

In Wetherspoon, we believe we have found a business that has successfully applied the tried-and-tested formula of some of the world's greatest low-cost retailers to the UK pub market:

- An unmatched depth and breadth of merchandise
- The lowest operating costs among its peers
- Shrewd buying power via huge volumes (which, given the negative working capital characteristics of the business, throws-off huge cashflows for equity owners)
- Gross margins (and prices) far below the competition
- Friendly and efficient service, consistently

Fig. 1: Mr. Market in denial - ROE rising, yet P/E falling



Source: Capital IQ, Holland Advisors

We also find in Wetherspoon a prudent business ethic that translates the above into impressive and improving returns, latterly through strong asset-efficiency gains. Later, we dispel the commonly held perception that returns are falling, arguing that the oft-cited cash returns used in this sector – the so called CROCCE – maybe are just not appropriate for this business. In fact the opposite is true: ROEs have averaged 15% over the last 10 years and 22% since the UK recession began in 2008 and return on tangible assets has risen.

Combining this with a business that has a strong track record in capital allocation (payouts have averaged 81% of Net income over the last 10 years) is we suggest, highly attractive. That the shares have been de-rated to just 9.8x EV/EBIT (11.2x historical P/E) as shown in Fig.1 indicates that Mr. Market sees it differently – hence the opportunity.

**Fig.2: Long-term track record (note similarity with Berkshire’s format – not a coincidence)**

Summary accounts for the years ended July 1984 to 2011					
Financial year	Total sales £000	Profit before tax and exceptional items £000	Earnings per share before exceptional items pence	Free cash flow £000	Free cash flow per share pence
1984	818	(7)	0.0		
1985	1,890	185	0.2		
1986	2,197	219	0.2		
1987	3,357	382	0.3		
1988	3,709	248	0.3		
1989	5,584	789	0.6	915	0.4
1990	7,047	603	0.4	732	0.4
1991	13,192	1,098	0.8	1,236	0.6
1992	21,380	2,020	1.9	3,563	2.1
1993	30,800	4,171	3.3	5,079	3.9
1994	46,600	6,477	3.6	8,284	5.1
1995	68,536	9,713	4.9	13,506	7.4
1996	100,480	15,200	7.8	20,972	11.2
1997	139,444	17,566	8.7	28,027	14.4
1998	188,515	20,165	9.9	28,448	14.5
1999	269,699	26,214	12.9	40,088	20.3
2000	369,628	36,052	11.8	49,296	24.2
2001	483,968	44,317	14.2	61,197	29.1
2002	601,295	53,568	16.6	71,370	33.5
2003	730,913	56,139	17.0	83,097	38.8
2004	787,126	54,074	17.7	73,477	36.7
2005	809,861	47,177	16.9	68,774	37.1
2006	847,516	58,388	24.1	69,712	42.1
2007	888,473	62,024	28.1	52,379	35.6
2008	907,500	58,228	27.6	71,411	50.6
2009	955,119	66,155	32.6	99,494	71.7
2010	996,327	71,015	36.0	71,344	52.9
2011	1,072,014	66,781	35.3	78,818	59.7

2011 FCF at 2004 levels  
**but**  
2011 FCF / share +60% since

Source: JD Wetherspoon 2011 Annual Report

In Fig.2 above we include a summary financials chart from Wetherspoon’s annual report for two reasons:

1. It mimics – intentionally – the style and substance of Berkshire Hathaway’s annual report summary table thereby giving investors a not-so-subtle hint as to Wetherspoon’s modus operandi

To view the remainder of this in-depth report, please contact Andrew Hollingworth, [Andrew@hollandadvisors.co.uk](mailto:Andrew@hollandadvisors.co.uk) for a complete PDF copy.

**Disclaimer**

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Services Authority (FSA) rules. Holland Advisors is authorised and regulated by the Financial Services Authority (FSA). This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by FSA). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.