HollAnd Advisors

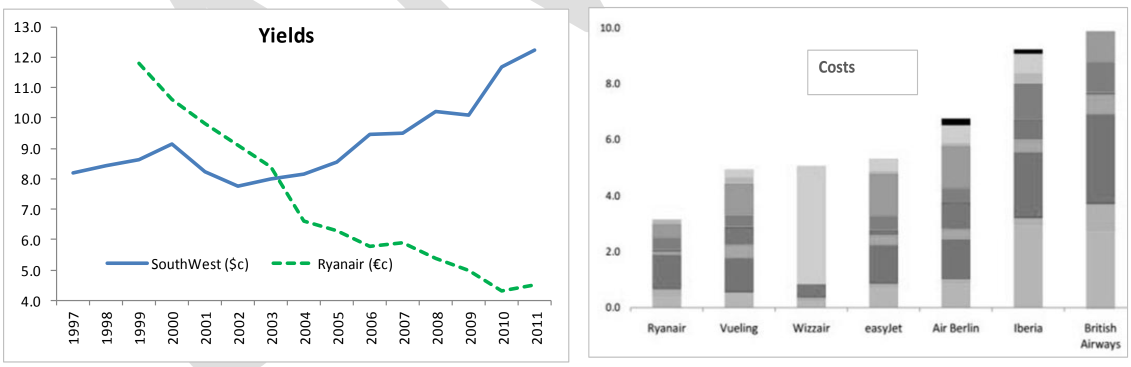
Holland Views – Ryanair (Price: €4.56, MCap: €6.5bn) Buy

War of Attrition

It is all too easy to dismiss stocks based on preconceived notions. Ryanair is a great example of a business that, were it in any other sector, would be deemed a clear 'Buy'. Of particular note is:

- A unique business model with structural cost advantages: Ryanair's unit *prices* are -23% below EasyJet's unit *costs.* Compounded sales growth of 21% and average ROEs of 15% since 2002 demonstrate the power of the Ryanair model thus far.
- The relentless (and self-imposed) suppression of Ryanair's prices in recent years point to *some* untapped pricing power today: Yields have been below unit costs since 2009.
- Our initial concern that slowing capacity growth (highlighted by the 2010 special-dividend) might have been an indication of a business model that is 'cashing in' were unfounded. The business model and management team seem as robust as ever.
- We conclude that the dominant and most successful businesses – especially those within commoditised sectors - employ similar business tactics and strategy even across sectors. Our work on retailers like Colruyt thus provided helpful parallels.
- Given the relative youth of Ryanair's business, SouthWest's 25-year head-start suggests that further organic growth is very plausible. Few companies have this organic growth and return prospects at a starting P/E of 11.5x historic earnings.

Fig.1: The extent of Ryanair's yield and (especially) cost suppression might surprise you



Source: Capital IQ, EasyJet analyst presentation

Ought We Be Admitted to AA ('Airlines Anonymous')?

Are we mad? Buffett's caustic views on the airline industry are well known and yet we dare to consider one. In the interests of opening client eyes to would be franchises on this side of the Atlantic however we must allow ourselves some latitude. Additionally our previous work on JD Wetherspoon showed that it is indeed possible to find good franchises in sectors which, on aggregate find it tough to make compelling returns.

It is with such pragmatism that we approached Ryanair - a disruptive but innovative business with impressive returns that dominates what is unarguably a gruesome industry. Whilst Ryanair is a well-known and ought to be a well-analysed business, our experience in identifying quality franchises across diverse industries allows us, we hope, to put Ryanair's business model in a new and possibly more useful context for investors.

SouthWest Airlines is deemed an obvious comparison and with a twenty-five year headstart, possibly offers comfort to Ryanair's growth prospects over the next decade. Less obvious perhaps are the similarities with some of the great high-volume global retail franchises – in particular our favourite European discounter, Colruyt and JD Wetherspoon. Structurally lower capacity growth in the European airline industry does not mean that Ryanair's business model is broken or has peaked, as its valuation (EV/EBIT of 9.3x) might imply. Rather it is Ryanair's relative growth prospects - effectively its market share of traffic - that will determine the sustainability of its business moat we believe. In short this is a business that ticks an awful lot of the boxes we look for: It has wide moat, allocates capital very well and is run by a hugely capable founder who is highly incentivised - if it were in any other sector, it would be a 'Buy'.

Fig.2: Ryanair's Return on Capital – not bad at all (especially for an airline)

Source: Holland Advisors

Ryanair – A Diamond In The Rough

"Ryanair is probably the most robust airline model we have encountered"

- Eric Hild, Boeing's Director of Sales (UK & IRL), 1998

Ryanair's dominance of its sector and its good returns come from a savvy understanding of how to thrive in a commodity business. Just like Belgian retailer Colruyt, it runs the business for volume whilst keeping costs low in absolute terms and importantly prices always lower than competitors in relative terms. The virtuous circle of greater traffic that results from such a strategy is very clear from the company's historic financials (see appendix).

Consequently, the question foremost on our mind (post the 2010 special dividend announcement and capacity slowdown) was: What is happening to the Ryanair business model? Does a greater cash payout and slower growth imply a weakening of it? Interestingly the current 11.5x PE when compared to its past valuation and most likely growth implies Mr Market is questioning the model too.

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

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