



Holland Views – Foxtons (Price: 195p, MCap: GBP546m)

Are we Dreaming?

Dream businesses – those that generate high returns, require little capital to grow and distribute excess cash – are always hard to find at attractive valuations. That we are willing to look somewhat favourably on a London estate agent in 2015 shows perhaps some pragmatism on our part (those of you who remember our work on the Credit Crunch pre-2007 will certainly agree).

Foxtons is a business that intrigues us. It is perhaps not quite the ‘Dream business’ that Buffett described in his 2007 annual letter but it does tick quite a few boxes. We do see a few analogies with Buffett’s darling See’s Candy – namely pricing power, brand strength, low cost of growth and surplus cash.

Another analogy comes to mind. This services business has an infamously aggressive sales culture and is always derided by competitors and sometimes even its customers. Yet it remains a market leader with exceptional returns – a Franchise. Much of its success lies in positioning itself in the best deals flow and selling those to clients. Yes, Foxtons we suggest, is a lot like Goldman Sachs!

Noting the 12x EV/EBIT and 16x P/E valuation, Foxtons is a business that:

- Enjoys pricing power relative to fragmented and unfocussed competition, due to its better customer experience. Simply put, they are good at selling houses fast.
- Aligned with that, it has built a strong focussed brand and renowned staff culture. Our discussions with competitors suggest that Foxtons is the Maverick in an industry characterised by sleepy franchisees.
- This ingrained service focus and sales-driven culture has become self-reinforcing as the company has grown and lead to a widening moat.
- This is also a business with significant operational leverage as seen in the 3% to 33% EBITA margin expansion in the last cycle (29% in 2014). Rising house prices are of course a tailwind but should not be seen in isolation of the excellent efficiency gains and expansion into lower priced localities.
- On this point, the business is indeed scaling very well (c.10% sales unit cagr since 2010 on the same headcount level!) – Well above the market trend.
- Rental management fees (lettings) are about half of the business and ought to offer considerable cyclical balance. Speaking of which, you might be surprised to hear that the groups still generated £7m in annual free cash flow in the dark days of 2008.
- With just c.5% volume share of the London sales market, future double-digit revenue growth is very plausible and, importantly, will be organically derived.
- Returns look very good too with RoNTA at c.100%. This is essentially a people business with a variable cost structure – again the analogy with Goldmans is apt or at a stretch Moody’s.
- Post debt restructuring, the business is once again debt-free and the management seem to ‘get’ capital allocation (note the Special Dividend already announced).
- Whilst the founders are no longer running Foxtons, the culture looks ingrained. We especially like the ‘promote from within’ attitude.

- With the stock down -50% in a year on fears of a volume slowdown in London sales ahead of the election – The shares trade on c.12x EV/EBIT or c.16x P/E. If targeted growth can be achieved this is too low a valuation.

So we have: high returns, the prospect of strong growth and decent capital allocation; is this enough to offset our lingering concerns about the ‘frothiness’ of the London market? We are not entirely sure but take some solace in the fact that London market volumes are down –35% from the 1996-2006 average. If you are relaxed about the London property market, then surely this is a share to own.

First, some confessions of a former estate agent and competitor of Foxtons...

We spoke recently at length with a friend who once ran several franchisees of a well-known competitor to Foxtons – now since retired. Without giving any hint of our own predisposition towards Foxtons, we were offered in intriguing insight into what it is like being a competitor of Foxtons.

From our man’s perspective:

- Foxtons was the first to run an estate agent office akin to a city trading desk i.e. 100% sales-led with aggressive incentives and employee competition. Banks of people on phones working long hours and driven by incentives and a ‘Hire & Fire’ culture.
- Yet very few estate agents had the culture or desire to emulate this. Despite their marketing claims, franchisees typically are self-interested and not incentivised to market properties outside their own catchment area. Foxtons by contrast had a company rather than branch mentality.
- In an industry he described as ‘sleepy’, Foxtons introduced a ‘fear-factor’ into its employees with aggressive internal competition and high staff turnover. But former Foxtons salespeople were always seen to be very well-trained and therefore sought-after.
- In fact, Foxtons was seen to be ‘run like a military machine’ using clever techniques to drive footfall and incentivise staff and entice potential customers.

Shock, Horror! Could Foxtons be a ‘Dream’ Business?

In his 2007 letter, Buffett laid-out the three types of business models: The Great, the Good and the Gruesome which we have discussed on numerous occasions (with our terminology altered slightly to Dream, Compounder and Gruesome respectively).

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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