

Holland Views – Howdens Joinery: Price: 362p; MCap: £2,293m

Double Agent

We love finding great businesses in unlikely sectors. Ryanair, Wetherspoons and Next are all Franchise-quality businesses located in sectors with typically poor economics; diamonds in the rough, as it were. We think we have found another great business in a lowly sector. Those familiar with the sector, but not with the company, are highly likely to have preconceived views.

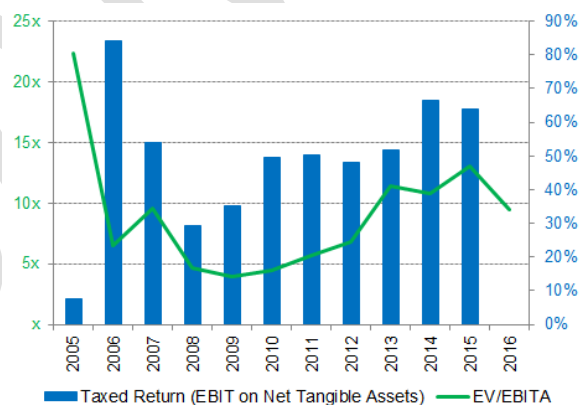
Howdens Joinery makes kitchens in the UK and that's enough to turn most investors off. Yet, it is the market leader by far, has superb returns (60%+) due to clear competitive moats and in some respects it is as interesting for what it has not done (no acquisitions, no unbridled expansion, etc.) as for what it has. Its business model and management culture is what really separates it from the rest.

We hadn't looked at this stock in detail since 2012. We liked it then but were wary of its pricing strategy. A new way of looking at its fairly unique 'agency' business model this time around finds us much more interested (and slightly annoyed with our earlier blinkered conclusion). Today, in a Brexit-obsessed UK stock market, and despite resilient current trading, we are offered the shares at a compelling 8.8x EV/EBIT and 12x PE ex-cash. BUY Howdens.

This note addresses Howdens'

- 1) Unique business model
- 2) Its excellent return on capital (and no less impressive allocation of it too)
- 3) and not least, its earnings power and valuation.

Fig.1: A 60% RoNTA market leader trading on 8.8x EV/EBIT



Source: Capital IQ

Understanding a unique business model

It is not always immediately obvious, how a business *really* makes sustainable profits, i.e. in the long run. The best companies invest time in understanding and building relationships with their customers to create specific solutions to their problems – solutions that are hard to replicate. Such companies are typically clear on their culture (often instilled by a hands-on founder manager) and – notably, in this case – are also very clear on *who* exactly is their customer and what it is that those customers really value.

1. Sometimes, Business Models *really* matter

Howdens is an incredibly customer-centric company. You might naturally assume that a kitchen company would assume that its customer is the homeowner. Not Howdens. In a historically fragmented market of independents and big-box chains, Howdens – the market leader in the UK kitchens market, solely sells ‘wholesale’, direct to builders. The builder, not the homeowner is the customer and this has major positive implications for the business model. The company’s unique business model is unchanged since inception in 1995 and its value proposition could not be clearer:

“Howdens is an original idea: to supply from local stock, nationwide, the small-builder’s ever-changing, routine, integrated Kitchen and joinery requirements, assuring best local price, no-call-back quality and confidential trade terms....

...we help builders make money” - Howdens Joinery 2015 annual report

Howdens employs a unique business model considering the market in which it participates. Unlike its high-street and big-box competitors who resell externally-sourced kitchen cabinets directly to homeowners, Howdens is vertically integrated and sells to the trade (i.e. builders and carpenters) via out of town ‘depots’. It manufactures the bulk of its cabinets, renowned for their high quality, in its own in-house joineries. The model is geared to builders’ needs with regard to stock availability and credit terms. The pricing model is intentionally non-transparent with builders in effect having discretion on the final pricing of kitchens sold to homeowners. Via the 330,000 or so builders who have accounts, Howdens in effect has an independent salesforce who have a very symbiotic commercial relationship with the company.

Below are a few excerpts – all direct quotes - from the company’s Report and Accounts:

1. *First, and principally, it is trade only, which means a constant focus on serving one customer – the small builder.*
2. *Second, we promise small builders everywhere that all our ranges are available locally, all the time, so they can pick up a complete kitchen when they need it, and they can finish their job and get paid by their customers, which means they can pay us.*
3. *Third, Howdens is a local business. We have 509 local depots, because builders do not want to waste time driving to and fro – they want to get on with the job. Their account is with their local depot. The depot staff know what each account customer needs. And so there are no misunderstandings, and no call centres, which saves everybody a lot of time, as well as money.*
4. *Fourth, we run Howdens as a focused and therefore low-cost operation, with high volumes and predictable sales. We have invested in our own manufacturing capability to ensure better service, greater efficiency, and no waste – whether of money, people, process or space.* – Howdens 2011 annual report

To view the remainder of this in-depth report, please contact Andrew Hollingworth, 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 Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. 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 Financial Conduct Authority). 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.