



**Holland Views: Whitbread – Price: £29.70, MCap: £4bn**

## What looks broken that isn't/What to buy?

We are looking/re-looking at many companies and focusing on those that have been hit hard but could:

- a) Offer great recovery potential and
- b) Prove more resilient to this downturn than Mr Market currently discounts

Whilst this approach suggests we are being opportunistic (and we are) we also still want to be invested alongside great managers, in businesses with strong market positions and potential for longer term compounding after a recovery is long forgotten.

### Whitbread

Whitbread is a company we have long been interested in, initially due to our appreciation of the Costa brand and then post looking more closely at the strength of product offering in Premier Inn. Premier Inn looks particularly interesting from our perspective of wanting to find the lowest cost providers in a sub-sector. Also, as we seek-out businesses' that deploy our 'put up more to make more' compounding model, it looks a good fit. Having looked again this week we are very happy that Whitbread should be the sort of company that appears at the bottom of our Covid-19 stock selection flow chart (attached again). Aka it is a survivor. To us the sell-off in the shares reflects short term trading worries rather than the likely resilience of this business or its longer-term compounding power. Indeed, we think when considering the life of the assets that Whitbread/Premier Inn control (either owned or leased) any lack of revenue in April/May 2020 is almost a non-event when looked at over the longer term. Attached is a recent presentation from the company which we have annotated. Our highlights from which would be:

- Premier Inn is a solid ROCE business (c.11-13%) that makes very good EBIT margins (24-27%)
- As consumers we consider it a winner in the price vs. quality trade off in UK mainstream hotels – Its brand being highly respected as such
- Its management display a good understanding of our 'Operate, Generate, Allocate' skillset
- The group is cash generative with maintenance CAPEX equalling depreciation
- It is pursuing a model in two geographic markets where US leading hotel chains have weaker brand positions and where there is significant scale to take share from independents
- This has all resulted in a significant consolidation of the UK sector by Premier Inn with its market share now at 11% up from 6% in only 2010

### Covid-19 resilience

- 61% of the company's sites are owned Freehold. These are carried in the books at £4.2bn and they have no leverage against them
- Excluding leases, the group had cash of c.£800m and Debt of the same amount at September 2019
- While the balance of sites (39%) are on long leaseholds we think there are many mitigating factors that should be considered vs. shorter term weak trading

1. That its long leases are just that, long in nature reflecting the long term (not short term) cashflows they produce. This is in contrast to say a fashion retailer. Indeed, it would be quite likely in such a relationship for the lessor to grant a rent holiday or delay in lease payments
  2. That this is an asset, rather than staff and opex heavy businesses is important. The hotels arguably have low/no costs if they are unmanned and not open even for protracted periods
  3. Were a business-like Premier Inn to have a technical default on a debt covenant what would be the point in its banks foreclosing on it? No other hotel company will be able to run these assets for as much cash generation as Whitbread in future years.
- Thus, we conclude that Whitbread like other companies that are getting through our COVID flow chart, in a worst-case scenario:
    1. Might emerge with bankers (or lessors) that have sought some greater security over other assets in the businesses
    2. Or they might emerge with slightly higher debt/lease costs
    3. Or some restriction on future cash deployment while some short-term debts incurred are repaid
    4. But importantly it is very unlikely the equity of this business will be impaired
  - As Chart 18 in the attached pack shows, Whitbread is operating in a market full of small independent hotels that do not make anything like the margins it does. Nor do they have its scale advantages or access to capital (hence Premier Inn taking share from them in past decade)
    1. Sadly, this means that during a downturn such as we are experiencing more small hotels will likely fail
    2. Resulting in a stronger and growing market share position for those like Premier Inn that offer a good, consistent product at compelling value
  - Premier Inn is exposed to the wider UK rather than London. As such were national as opposed to international activity allowed to re-start post the current Covid-lock down period (a most likely scenario we think) non-London locations would benefit first relative to those relying on international traffic. This in turn suggest Whitbread's attraction over a London hotel chain, or an airline.

### Valuation

We, like many of our clients, are looking at far more stocks in a short space of time than usual. In considering the valuation of Whitbread we will make a couple of observations:

- Pre Covid-19 Whitbread was expected to make c.£300m in Net Income. However as per slide 11 this reflects a ROCE of 10.8% down from 13.3% twelve months before, partly due to cost inflation (maybe not passed on?) and German expansion costs. A return to this past ROCE level would indicate Net Income of c.£370m

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.

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