Holland Views

Mo Farah's recovery portfolio + Be Bullish

"Where did all my competitors go?"

The market has had its first sniff of recovery. We are interested in the best businesses that have the greatest and most lasting recovery potential. Mr Market we note is a long long way from working that out yet. We are very bullish on 2021, but sadly only have two pairs of hands!

A little reflection to start

2020 has been a brutally busy year for us here at Holland. Like you all we have gone from the normal work of assessing weak vs. stronger business models and operational gearing to cash survival analysis, doing so in some cases with sales not -20% but at zero. Mark and I are proud of the experience we have picked up along our analytical journeys over the past combined 50 years of market watching. Dramatic cycle changes we are ready for, but stress testing capital structures for zero revenues, let's face it, was a real challenge.

During the summer period we tried to do what we thought would help you as investors. I.e., come up with new ideas of companies we thought had become mispriced in the selloff. In truth doing so with an analytical staff of two is extremely hard. We are proud of our ability to move across sectors and geographies, taking what we learn from one to another. That said jumping into Ashtead, Aena, Brembo or Hiscox in the middle of pandemic is not easy. Especially so when our readership is of a really high standard (we would have it no other way). If in 2020 we were working in a different role that gave us greater access to resources (say as a Head of Research) we would have been encouraging others to look at a broader range of ideas. These would mostly fall under a heading we will call – *"where did all my competitors go"*. We still think there is time to do this work now.

Mo Farah's recovery portfolio

Imagine you are Mo Farah. You train like hell, year after year. Each year to turn up to the World Championships and there is 1/100th of second between you and your nearest four competitors. You do the same each and every year. You try and try and you are almost winning but the gaps between you in the silver medal spot and gold in front and bronze behind is still a tiny fraction of a second.

Then in 2020 you turn up for DIVOC 91 Olympics. It is the semi-final of the 5,000 meters. On the back straight a slightly odd-looking chap you have never seen before seems to trip one of your main rivals. Your rival falls and does not make the final. The next day is the final, you are very focused on your race and are out in front. Normally your nemeses will be right on your shoulder on the final bend for his 'kick' finish to beat you to the line. On the back straight you hear a scuffle behind you but daren't look back. You just keep running. When the final bend comes, you glance at your shoulder to find no one there. You look again to see no one is within 10 yards of you. Across the track your second rival lies injured, studs down his calf, a second victim of this strange DIVOC 91 Olympics…You think to yourself: *"where have all my competitors gone?"*

Where did my (big) competitors go?

The best recovery ideas coming out of this crisis we think will fall under this heading. In some cases, the failures are obvious (Norwegian fails so Wizz and Ryan have outperformed) but it is often far more nuanced than that. Indeed, the airline sector is one that has seen huge bailouts. Many see this as bad news for the sector, we see it as long-term good news as it has just made the high cost/low cost gap even bigger and the customer in time will notice. Arguably the biggest beneficiary of Norwegian's failure is IAG. After all, long haul was Norwegian's dream and their challenge to BA on a number of routes brought lower prices to routes that BA (IAG) held a monopoly on. That monopoly will return one day soon. The difficulty of a three-person operation like ours is that it is hard to be able to get into the detail enough of each and every idea to give the conviction we would want on such a share; especially when they are a) cyclical ideas and b) there have been capital structure changes of late. That said with our Head of Research hats on we would be telling others around us to spend much time on IAG right now. (**Or companies like it that fit this remit of having failed competitors)**

Another company that looks strongly positioned in that in regard is Whitbread. We briefly wrote about it in the summer, but again we were time limited. Whitbread recently spoke of having increased its Premier Inn market share over the summer months in the UK by c.30%. This is a remarkable statistic (from 8% to 10% of rooms sold). They also spoke of some freehold owners of Travelodge hotels re-bannering themselves as Premier Inn during too. Going back to the Mo Farah story when we think of how hard it is to get a market share position of say 8%. A period that enables you to jump 2% share points just in a few months can make a massive difference to the scale of your footprint and brand in the longer term.

As is the case with IAG, post a rights issue Whitbread looks equity heavy and customer demand light right now. As such it is hardly an attractive investment for the asset light groupies of 2015-2020. For those of us prepared to think differently maybe these businesses are more interesting. Sometimes to build a moat takes times yes, but also capital (when others do not have it) and an ability to endure pain for a while. These could be very interesting opportunities. Those of you with deep analytical resources at your finger-tips should be getting them to work hard in these areas. **We would love to hear of others you think are similar.**

Where did my (small) competitors go?

The failures of Norwegian and Travelodge are visible for us as investors to see. What is less visible is the failure of many smaller businesses (gyms, hotels, restaurants) and yet these will play an equally strong role in future market share movements too. Many of us have seen the generic Investor Relations pie chart that shows market leader share, number 2 share, number 3 share and 'independents'. The independents are too small to name and don't have listings. They don't put out RNS releases. Some will have had help from their banks, some will have benefited from furloughs, but many will have suffered in a less than fair way.

Indeed, that the UK bailout system helped the small self-employed, but by excluded all those who are Directors has in fact hurt many businesses who might have been quite strong otherwise. Arguably those perhaps who were gaining strength to challenge bigger players in time..? An example I could write at length about is my local gym which was the best of six in my town. It was loved. People left David Lloyd to work there and train there. ALL the classes had wait lists. It was THE place to work-out locally run by a great husband and wife team. But it went bankrupt when Gym Group, David Lloyd and the work at home personal trainers survived. Why? They had the right kit, the right brand, classes, website +++.

They just had the wrong lease with the wrong landlord at the wrong time. That does not matter when you are either big OR successful OR if sales are down 20-30%. It matters a great deal if they are down 100%. It was a tragic personal local story because the business was so strong before.

Pubs, sarnies and gyms

The implication of these sorts of trends are harder to see for stock market investors but still important. Companies like Gym Group and David Lloyd suddenly look a lot lot better placed locally than they did post the closure of my local gym, without them doing very much right. Is that the case nationally? Is that happening also to sandwich shops and coffee shops where there is a strong independent sector too? In reference to Whitbread above we note that the hotel sector has a huge independent component. In the summer we singled out Greggs as a benefactor of this trend. In its case, that its peers were mostly London-centric in their base and the damage done to these businesses in the first lockdown (Pret/Leon etc.) as well as that to the independents must surely help Greggs win shares in the normalisation when it comes.

Another affected sector is pubs. Listening to the Young's call yesterday the group has been doing extensive works on its pubs to extend gardens and upgraded its app faster than planned. JDW has been doing the same. Being a visitor to pubs it always fascinates us the difference between those (big and small) that really make the experience better for the customer and those that don't. Listening to Greggs, Young's and JDW talk about how fast they were able to roll out their app upgrades and home delivery (Greggs) vs. other local eating out experiences in the summer (good and bad) tells us that the strong will only get stronger post this crisis

Might these be the crisis Tim Martin needed?

Readers know that we are admirers of the JDW pricing policy. Also, that we think one day a little operational gearing will show up in this business when they just cannot find any more staff to pay and any more beer to give away at silly low prices! A few years ago, we managed to get a few minutes with Tim at the back of the Crosse Keys. We asked about this point. I.e. when might the long awaited operational gearing arrive, and it be good to be a JDW shareholder rather than just an employee or customer? Tim answered by describing the competitive situation in the pub sector in the 1990/2000's and the restaurant sector today. He pointed out that during past over-investments in the UK pub estate (via companies like Punch and Enterprise) JDW sales and profits were depressed. When that bubble burst, he noted JDW did really well. He went on to say that there had then been a huge over investment of capital in the restaurant sector (we were talking in c.2018). He cited new branches of Jamie's and Carrluccio's across London-all half empty. He observed that when that capacity left the restaurant sector, like it left the pub sector, JDW would do well.

At the time this was not the answer I wanted (rarely are they!) The Sam Walton in him knew that he just had to keep charging the low prices, build the brand and… wait. As Covid has decimated the restaurant sector this year Tim's reflection on that day in 2018 has often returned to me. With the company in technical breach of its covenants, losing £14m a month and the pubs shut it feels a strange time to talk about their competitive strength. We will see.

VAT, pricing importance + Tim's Rants

The other interesting aspect of these consumer areas like eating out and pubs currently is pricing. The change in VAT has brought about either help to operator profits or bigger gaps in pricing depending on who passed on the VAT cut and who did not. Again, from yesterday's Young's call we learnt that they had originally passed the VAT cut on to customers in the summer, but quietly they have now pocketed it, meaning they will have put prices up.

JDW by contrast have kept prices low (indeed did you grab those 99p pints the day before lock down - My sons did). These differences matter little when pubs are shut (!) or when trading is light, but when pricing gaps are already big and trading normalises next year the customer will notice. Not directly between say Youngs and JDW for they are serving different market, but vs local peers who acted differently. Another example is Greggs. It has passed the VAT cut on in the summer, but my local sandwich shop did not (again scale advantages in evidence).

We will be honest and state that do not always agree with Tim Martin's use of JDW investor releases for some of his personal views. Sometimes would like him to tell us a little more on his thoughts about the business. However, we do hugely admire the tenacity he has for a cause. Indeed, that the Chancellor cut the VAT on pubs during this pandemic is interesting as this has been a permanent policy Tim has been campaigning on for years now. Tim has (rightly) sought tax equality between pubs and supermarkets, a policy that most other EU countries now have. Having noticed this issue and made this change in the summer we wonder if it is likely that the Chancellor might make it permanent in the Spring. He clearly will be looking to balance the books so taxes will be going up on capital gains and the like, but populist tax cuts are always well – popular. It would help the man on the street and a sector that desperately needs it. If the Chancellor does so it will be solely Tim's doing, as for some inexplicable reason the sector has never backed his call on this issue.

Your ideas

We would love to hear your stock ideas that fit this 'lost competitor' thesis. We are particularly attracted to sectors that were already seeing supply side discipline on capacity. We think the equipment rental sector interesting. Here in the UK and US there are plenty of independents who will have found it very very hard to compete with the services offered by United and Ashtead in this period. We are interest to hear of others…?

"Be Bullish"

Working as analysts with sceptical eyes at Merrill Lynch, in the years leading up to the 2000 boom/bust under the motto of "Be Bullish" always somewhat irked us both. It seemed to fly in the face of the cautious, risk averse investing path we believed right to follow. (Your authors both left in 2004). However, in our long investing careers we have rarely felt this phase is more apt that today. It must be remembered this is not from investor writing based in Wall Street, but from one sitting in London- seemingly the most hated investing market in the world

Almost exactly one year ago we were predicting the outcome of the UK general election. We were right, right and then very wrong. We thought that the Conservatives would win by a strong majority (right). We thought that a Brexit deal of sorts would get agreed (right). As a result, we thought the UK was poised for strong period of economic recovery (wrong – in fact, very wrong thanks to Covid). So what about today:

- The Pfizer news is universally bullish on scale that we think many investors and the wider population are struggling to adjust to. It having a number of knock-on positive consequences such as the likelihood of other vaccines being more likely to work
- It seems almost likely now that a second vaccine (Astra Zeneca – mentioned by Matt Hancock on Question Time last night?) might have good efficacy as well as it uses the same approach. We will find out in next few weeks.
- Some form of Brexit resolution is likely. For all sides the logic in finding a form of compromise would seem logical. This again will come in short order.

- Political stability is arriving in the form of centrist Democrat President's but still a strong republican representation in Congress and Senate
- A new phase of UK government may start with the new year - with the quiet departure of Dominic Cummings (ref. Spitting Image – 'you cannot fire me')
- The scale of pent up demand for consumption and feel good factor in Western economies in Spring/Summer 2021 we feel is simply enormous. This will likely more clearly emerge in early Spring as the virus naturally fades (due to its seasonality) and the vaccine will have been rolled out in some scale
- The only analogy to such a period is maybe the post-war boom years, but this time people have greater access to credit. For some also there was no loss of earnings at all, just a loss of the ability to spend. We should remind ourselves too that the drivers of wealth for the lucky in society are unchanged - neither property values nor equity markets have fallen
- This will all come with uber low interest rates and central banks that are so delighted to see growth resume they will not want to be party poopers.
- ….and with with western politicians who have committed to a scale of fiscal spending rarely before seen.
- **This has all the makings of a multi-faceted multiyear boom…for now**

Roaring Tigers

The sceptics will shout 'bubble' and 'inflation' as we might have done 20 years ago at the first sign of any good news! But it is hard to have an inflation when GDP is still down 10% on its peak that was only last year. Every day since last April every economic doomster has been too bearish on the economy – all the way up they have failed to understand global workers and consumers resilience. The 'Caged Tiger' we spoke of last May has bounced back in some sectors, but boy oh boy how she wants to get out of the house, go on holiday etc. The recovery in the demand for these sectors could be unprecedented not just in terms of demand, but soon after that in pricing also. (Ref our Ryanair piece *'Feast to follow famine'*). If capacity is down and demand goes crazy, pricing will spike and margins will snap back 'real fast' as our North American friends like to say.

Our work over the summer has been focused on this normalisation and trying to profit not just from its snap back but by being well positioned in companies that end up being lasting beneficiaries of this crisis that were overlooked at the time. Being early to call recovery ideas feels pretty much the same as being wrong until…. maybe you are right. All you need is the sun to come up, spring to arrive or a Pfizer's silver bullet! Maybe even an Astra golden one to follow it.

This week's share price recoveries have seen many hated shares boom and many commentators who were happy to find reasons to recommend the sale of such shares on the way down, now find reasons to encourage the layman to hold on a little longer or buy: *'I am now hearing the summer 2021 cruise booking season is looking stronger, so I would hold on'* Such is the way of markets, the cycles they move in and those that earn a living commentating on their every whim.

We too earn a living from them, but our role is to try and help clients profit from taking the contrarian approach to Mr Market's mood swings by buying good businesses when they are offered for sale. This for us was the state of play for much of the leisure and tourism (it should be noted, normally growth) sectors in 2020. Thus, once we felt the market lows had passed us in the Spring, we set about trying to identify contrarian value.

In occasional cases our notes were published close to share price lows (Aena and Ashtead). In others we went to print far too early (Greggs). Such crude score keeping misses the point. The time to start looking for those contrarian ideas was as the market fell, the time to stop looking for them, is not yet.

Where we have done enough work on a company to understand its capital structure, competitive position and compounding abilities in the long term we write pieces outlining its attraction to you. As you will have gleaned from our thoughts in recent months, we think this a target rich environment. There are likely many more attractive stocks in the market today than we can do the required work on in the time left, but we will share our ideas in all forms. We would be delighted to look at other companies you think might make a Mo Farah portfolio. Happy recovery hurting

As the Thundering Herd used repeat ad-nauseum- ***"Be Bullish"***

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