HollAnd Advisors

Holland Views – Next plc (Price: £68.89, Mkt Cap: £10,188m)

What we can't measure often matters more

The bulk of our time is spent trying to understand and describe the best business models, which we call 'Franchises'. We strive to do this with a consistent approach and a long-term investment horizon. The decision to then write on a company is normally predicated on either the idea being actionable (i.e. the share is cheap enough for us to believe it should be bought) or when a previously held view is realised to be wrong, as our analytical conclusion has changed. Next today fulfils neither of those reasons. It is no longer cheap at a PE of 18x, nor has our analysis of the company changed - far from it. We write because we feel there is much we can all learn from the Next business model and the way it is executed by Lord Wolfson and his team.

Phil fisher under our noses

We wrote a piece a few years back that looked at Next through the eyes of the legendary growth investor Phil Fisher. We asserted then that the group had many of the traits that such an investor sought. We attach earlier pieces so will not repeat all our conclusions but highlight a couple we think are relevant when considering the company today:

1. What you can see:

Once an investor knows what they are looking for in a company's financial metrics, Next stands out head and shoulder above many others in the UK.

a. It makes high returns on both tangible assets and equity
b. It then allocates capital very wisely via organic growth investments, through cancelling shares or the distribution of any excess by way of special dividends.
c. As a result, the groups historic per share growth rate in sales or earnings is even more impressive than companies like H+M and Inditext, who for a long time have been held up as the industry idols.

2. …and what you can't:

Of arguably greater (or at least equal) importance to these tangible yardsticks is the less measurable side of Next's business model - in effect its business culture. This is multifaceted but, we suggest, demonstrates itself in:

a. Excellent product execution and customer service innovation
b. Constant generation of new organically developed business lines, such as Directory, Directory Overseas, Homeware and now LABEL

We will be honest (and a little immodest, truth be told) for a moment and admit to being proud of our work on Next. But we will not dwell as we (and you) have more than enough evidence also of the mistakes we have made in other company analysis. Crucial to our understanding of Next when we looked afresh in 2011 was having then recently read the renowned Phil Fisher book ('*Common Stocks, Uncommon Profits*').

There were many points in the book that remain highly relevant to identifying what he called 'growth stocks' and we label 'high-quality franchises' but perhaps the key one which we assessed as evident in Next plc was the ability to innovate and thus internally generate new sources of future growth for the business. [Please see the appendix of this note where a Phil Fisher checklist of those traits is shown.]

Next plc today

We have stated before that most stock-broking research on Next is largely redundant (yet, Next is one of our most written-about stocks!!). As we wrote in March of this year:

> "This is a company that demonstrates an all-too-rare clarity in how it runs its affairs and communicates them with shareholders very clearly. Day to day operations, assessing future growth opportunities and capital allocation are not only exceptionally well executed but also well communicated with stakeholders.
>
> "There is nothing clever or complex in this business model (or its communication) at all. It is just common sense and good long-term business management combined with excellent investment logic. In fact this point is made by the group when it outlines its five "straightforward" objectives that have changed little in the last 3 years.
>
> "There is a great understanding of the importance of returns and marginal returns – again this is demonstrated by the section that shows what percentage of group profitability comes from which stores and the forecast payback period for capital invested in new stores.
>
> "Lastly there is an understanding of capital allocation that, frankly, is as rare as hens teeth amongst other UK quoted companies:"
>
> > *"Cash flow was again strong and we continued our share buybacks… reducing our shares in issue by 3.8%. During the year we returned £461m to shareholders through share buybacks and dividends.*
> >
> > *"Our share price again performed well, rising by 55% to £62.80. As a result of the increase, we stopped buying back our own shares at the end of October and have instead started to return surplus cash to shareholders through special dividends. We will reconsider buybacks when to do so would give an effective 8% return on the cash invested.*" - John Barton, Chairman

Source: Holland Note 'Next (is) and Majestic' - March 2014

The recent (September 2014) Interim results were yet another excellent example of a good business model communicating well and we recommend them most highly. We include a few excerpts which we think demonstrate the results of the historical investments and innovations the group has made. They also suggest that such drivers are still highly evident in the group today.

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

Andrew & Mark **firstname@hollandadvisors.co.uk**

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as managers to.

Contact:

HollAnd Advisors

Holland Advisors London Limited
The Granary, 1 Waverley Lane
Farnham, Surrey
GU9 8BB

Tel: (0)871 222 5521
Mob: (0)7775 826863
www.hollandadvisors.co.uk

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.