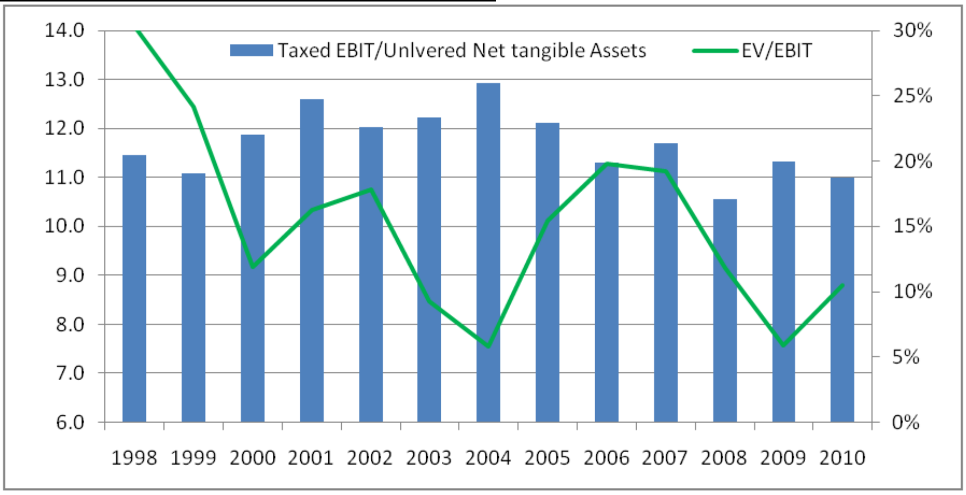
HollAnd Advisors

## Holland Notes – Greggs Price: £17; MCap: £1.7bn

# Pies + Pivots

We have been Greggs lovers for many years now. Not only do we love the value we get when we pop in for a 50p chocolate chip cookie or £1 sausage roll but we also loved the value on offered a while back in the shares. The chart below is extracted from one of our earlier pieces of research on the company back in 2011 (*Holland Views – Greggs, More of the same – 483p, March 2011*). It showed that Greggs was a great compounder of shareholder capital making c.20% returns on tangible assets. Also, that the company's shares could then be purchased relatively cheaply for c.8-9x EV/EBIT. At that date Greggs shares were 489p vs. today's price of £16. Whilst much has changed in the world between 2011-2020 some things are reassuringly stable.

Fig.1: The combination of traits we liked in 2011



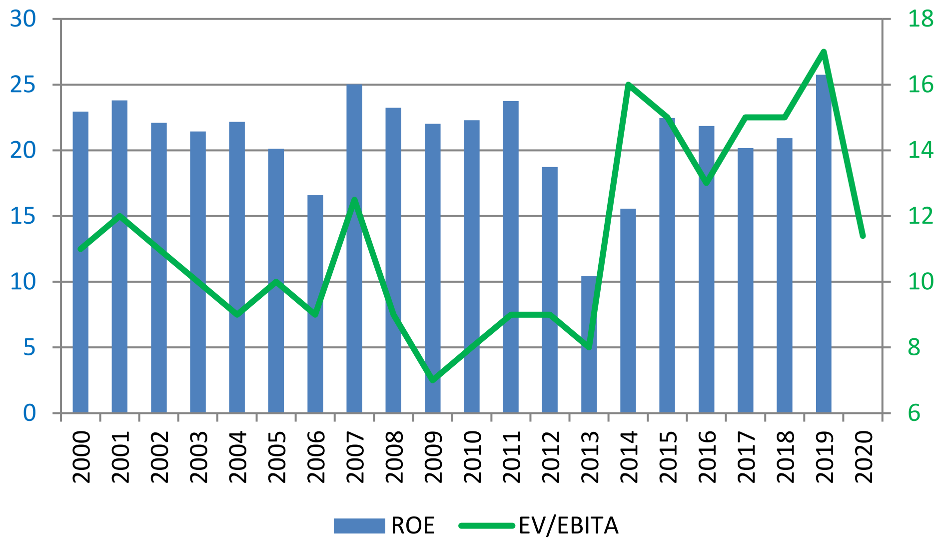

**Source: Holland Views on Greggs - 2011**

Fig.2 shows a similar return on equity chart for Greggs in the most recent 10 years and also the average valuation (EV/EBIT) Mr Market has placed upon the shares in each of those years. We hope that two conclusions are self-evident:

1. That the stability of returns made by this company in our second decade of study are notable and remarkable in their resilience
2. That Mr Market having been somewhat stingy with the multiple it put on Greggs at the time of our writing in 2011 became much more generous in the years that followed

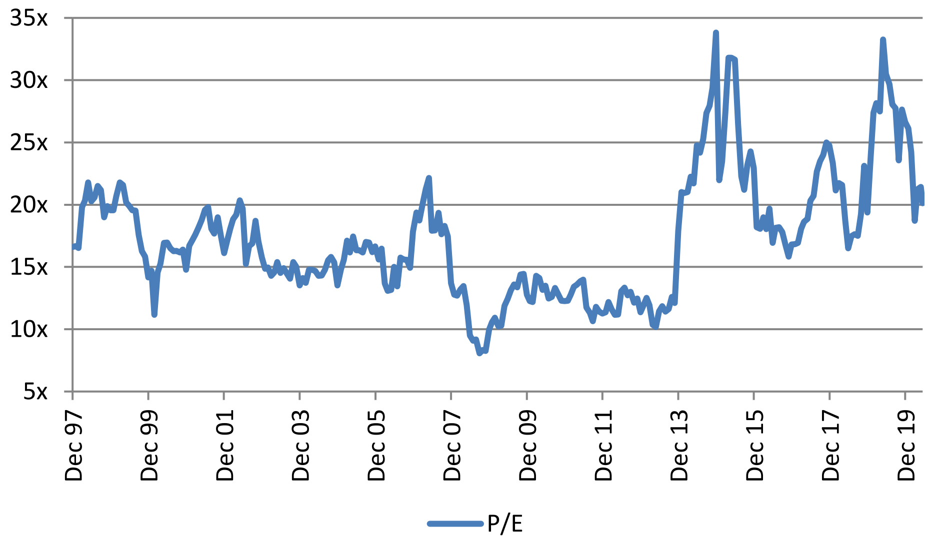
Indeed, when first looking at the company in 2009-2011 we noted then the much higher past multiple that had been placed on the share in the years 1995-2006; a prospect we thought it possible to return to. The full cycle of these different multiples placed on this remarkedly stable business can be seen in Fig.3 which shows the PE since 1997.

Fig.2: ROE vs. EV/EBIT 2000-2019




**Source: Bloomberg**

Fig.3: Past 20-year PE




**Source: Bloomberg**

## History rhymes

Greggs has its fans and followers and thus a more detailed study of its past is of little use to us as researchers or many investors reading this. A high-level historical reflection however does provide context for the business today. Simply put, for all of Greggs super stable returns over decades it has been its near-term growth metrics that have driven the speed of its compounding but also the multiple the shares have traded on. In periods of stronger or weaker growth those recent trends were implicitly extrapolated by Mr Market.

With an informed readership we will not explain why Covid-19's first + second order effects have hurt the company's shares. (1st Order: all shops are shut// 2nd order assumes long term damage to office attendance/wider economy). Instead we reflect on why we believe this company will recover far more strongly from its Covid-19 trough than currently Mr Market anticipates.

## Supply side

In our various reflections on the business world outlook post Covid we are seeing plenty of examples of businesses that will become relatively stronger in their sectors as competitors fail. Greggs is a stand out company in this regard. The higher priced competitors of Greggs are nearly all London based/founded, due to the size of its addressable market. This combination of London-centric locations, higher selling prices and start-up/private equity funding could be a disaster for many such businesses. In addition, many independent sandwich shops may fail too. A separate point is that many of these companies (large and small) rely on the wholesale supply chain to supply some of what they sell. In contrast, Greggs is not only very well capitalised (£1.6bn MCap + Net cash), but it also controls its own supply chain and brand. A brand that is known for offering great value for money, the key differentiator in difficult economic times.

## The Pivot

A key driver of this company's change in fortunes in 2013 was the appointment for a new CEO (Roger Whiteside) and the pivot he made to the company's business model, i.e. they stopped selling bread, sold more coffee + became a food-on-the-go business as opposed to a bakery/sandwich shop.

Acknowledging this pivot we think is a crucial in understanding Greggs as an investment today. If need be this company has both the brand/low cost positioning, scale and management to pivot again towards what a new, post-2020, customer may want. Examples might be:

a. Maybe more local stores. The franchise format could be very powerful in this regard
b. Maybe they start delivery to local factories/office complexes/JV with delivery company
c. Menu in window so you download the app whilst queuing – your order is bagged up and ready to collect when you enter
d. Social distancing is already done by Greggs customers as they queue outside and love to do so!

## The 'death of the office' bandwagon

That statistically more people will work from home post-Covid than did before is a simple and likely conclusion. That this will account for a large proportion of past time in offices is not a given however. Nor is it a given that people will not spend the disposable income they save on less commuting/lunches. Nor simple to assume that all those making their own lunch to eat in the garden currently will continue to enjoy doing so when lockdown ends.

**Consumers have tastes, habits and for 50+ years have loved the convenience that food-on-the-go provides them**. Companies like McDonald's (shares only 12% off pre Covid high) Subway and Greggs are at the forefront of this secular trend. To assume that we will become a nation (or world) of long-lasting home bakers we think is folly. That some city centre/London orientated higher piece chains will fail is realistic. Greggs is none of those things; instead it is a beneficiary of competitor contraction and a renewed customer focus on value

The London centric point we think is important. Lots of competitor brands are built and established there and they often provide the food-on-the-go experience that many investors have. Some such investors we feel are over extrapolating their own recent experiences into the wider community assuming greater change will be long lasting.

Indeed, in times of stress for businesses like Greggs/Ryan/Frasers or JDW we have always found the London investor view of them to be in some way skewed. When growth is good investors are fans, but when it stumbles, they can fail to see the powerful attraction that these value for money-based brands have to the c.50m that live outside the M25.

Last week we were on conference call for a Yorkshire base company. The Chairman, whom we greatly admire, pushed back when an analyst talked about companies not going back to the office ever in the same way. We paraphrase, but this was the gist of his reply:

> *“that might be good for you lot who commute to London every day, but not for us up here in the North. There is plenty of space and we can drive to work and we enjoy seeing each other, so not much is going to change”.* This we think is wisdom vs. the recency bias many others are spouting on ‘the death of the office.’

Many may well be enjoying life at home with family while the sun shines, but the novelty we believe could quickly fade. People will yearn for interaction, the office, the pub and of course a cheeky Gregg’s.

Great companies, at good prices

Our strategy remains the same, try to buy great businesses when they are not priced like them. Exactly what the future holds for Greggs in terms of 2020 like for like sales on re-opening, or the need for a repositioning of the estate we do not know. What is clear is that this is a company with both an excellent, trusted brand and the wisdom and ability to pivot itself to offer what its customers want, **and more importantly where they want it.** Mr Market is doing what he does best, extrapolating near-term trends. That these trends are uncertain is why today he is offering Greggs to us at a more compelling price than has been of late (EV/EBIT of 13x and PE of 17x on Nov 2019 financials). These are not the bargain levels of 2009-2011, but low enough to have appeal we suggest for brand and compound seeking investors.

**Buy Greggs**

PS: We can feel ourselves salivating for a stake bake as we write!

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