

# **Deep Value, Cyclical and Cheap Compounders: 3 ideas worth investing your time**

Value Investing Seminar, Cyprus

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# What would you pay for £140m book value with up to £50m in hidden land assets?

## Group segment structure

| Core Trading (pre Group Overhead)  | Value Creation Projects & Property   | Legacy Realisations   |
|--|--|---|
| <p>Medium Term Operating Profit Aspiration:</p> <p><b>£10m - £15m</b></p> <p><i>Central Overhead expected to be c.£5m p.a.</i></p> | <p>5-Year Incremental Value Generation:</p> <p><b>£35m - £50m</b></p>  | <p>Legacy Assets Cash Run Out:</p> <p><b>~£66m</b></p>  |
| <p>Profitable and sustainable ongoing business with growth opportunities and tight capital discipline</p> <p><i>Long Term</i></p>  | <p>Finite activity stream focused on extracting maximum value – low book value with high potential returns</p> <p><i>Medium Term</i></p> | <p>Wind down of assets into cash as Group withdraws from legacy markets – highly cash generative</p> <p><i>Short Term</i></p> |
| <p>Indicative Net Assets at Mar 16:</p> <p><b>£52m</b></p>   | <p>Indicative Net Assets at Mar 16:</p> <p><b>£22m</b></p>   | <p>Indicative Net Assets at Mar 16:</p> <p><b>£66m</b></p>  |

Return on capital ~ 20%

# Hargreaves Services is on sale at <£60m

## Group segment structure

| Core Operations   | Property & Energy  | Legacy Realisations  |
|---|--|--|
| <ul style="list-style-type: none"><li>• <b>Coal Distribution</b><ul style="list-style-type: none"><li>• UK speciality markets</li><li>• Single site production</li><li>• Europe trading business (investment)</li></ul></li><li>• <b>Services</b><ul style="list-style-type: none"><li>• <b>Specialist Earthworks Services</b><ul style="list-style-type: none"><li>○ Infrastructure, Construction &amp; Civils</li><li>○ Contract Quarrying &amp; Contract Mining</li><li>○ Restoration &amp; Remediation Services</li></ul></li><li>• <b>Industrial Services</b><ul style="list-style-type: none"><li>○ UK</li><li>○ International</li></ul></li></ul></li><li>• <b>Transport &amp; Logistics</b></li></ul> | <ul style="list-style-type: none"><li>• <b>Energy Projects</b><ul style="list-style-type: none"><li>• Energy-from-Waste</li><li>• Onshore Wind</li><li>• Exploit existing grid connections</li><li>• Solar</li></ul></li><li>• <b>Property &amp; Developments Portfolio</b><ul style="list-style-type: none"><li>• Planning and development gain</li><li>• Rental streams from tenants</li><li>• Sites used for core operations</li><li>• Sale of surplus properties</li></ul></li></ul> | <ul style="list-style-type: none"><li>• <b>Inventory Realisation</b><ul style="list-style-type: none"><li>○ Thermal coal</li><li>○ Coking coal</li><li>○ Coke</li></ul></li><li>• <b>Surplus Yellow Plant</b></li><li>• <b>Tower</b></li><li>• <b>Maltby</b><ul style="list-style-type: none"><li>○ Pension</li><li>○ Underground mining equipment</li></ul></li></ul> |

Value added mainly through land sales or leases rather than operating the assets

# Why now?

- Share price @ £1.90 compares to all-time high of £12 (2012) and low of £1.55 (April 2016)
- Sentiment dominated by 'coal' image, short-term trading and complexity
- No longer a coal story - shed its legacy (open-cast) mining and trading operations - releasing excess inventory, Caterpillar plant and land
- Good capital allocation
  - Assembled by purchasing cheap assets from distressed sellers
  - Disposed of Imperial Tankers in September 2014 for £28m compared to book value of £9.5m (acquired in 2004 for £6m)
  - Will now likely buyback shares via tender offer following initial asset liquidation
- Founder/CEO bought 205k more shares at 170p on April 28 taking his stake to 7.8%. Three other board members bought the same day

# Background

- Invest family capital
- Advise private clients
- Occasional consultant (pricing)



- Professional investor since 2007
- Previously a software entrepreneur, strategy consultant and engineer
- MA Engineering (Cambridge) 1979
- MBA (London Business School) 1989

# Investment style

- |   |   |
|---|---|
| <ul style="list-style-type: none"><li>• Deep value, cyclicals and cheap compounders (often disguised by accounting)</li></ul> | <ul style="list-style-type: none"><li>• Contrarian, cheap-skate</li></ul>                         |
| <ul style="list-style-type: none"><li>• Industrials, consumer-discretionary, non-bank financials</li></ul>                    | <ul style="list-style-type: none"><li>• NOT banks, miners, drugs, utilities, most tech</li></ul>  |
| <ul style="list-style-type: none"><li>• Owner-managed businesses</li></ul>  | <ul style="list-style-type: none"><li>• Worst mistakes from poor capital allocation</li></ul>     |
| <ul style="list-style-type: none"><li>• Small-cap and UK biased</li></ul>   | <ul style="list-style-type: none"><li>• Process outcomes not design</li></ul>                     |
| <ul style="list-style-type: none"><li>• Don't want dividends</li></ul>  | <ul style="list-style-type: none"><li>• Buy-backs more efficient for undervalued stocks</li></ul> |
| <ul style="list-style-type: none"><li>• Concentrated portfolio</li></ul>  | <ul style="list-style-type: none"><li>• Multi-baggers are rare</li></ul>                          |

# Position-sizing and risk management

- 10 stocks contribute 70%; 10 stocks 30%
- Largest positions:
  - Great capital allocation
  - Long experience
  - Highest margin of safety/upside
- Risk management:
  - Sound companies, cheap prices and long-term horizon
  - Cash, including USD, and special-situation bonds when nothing to buy

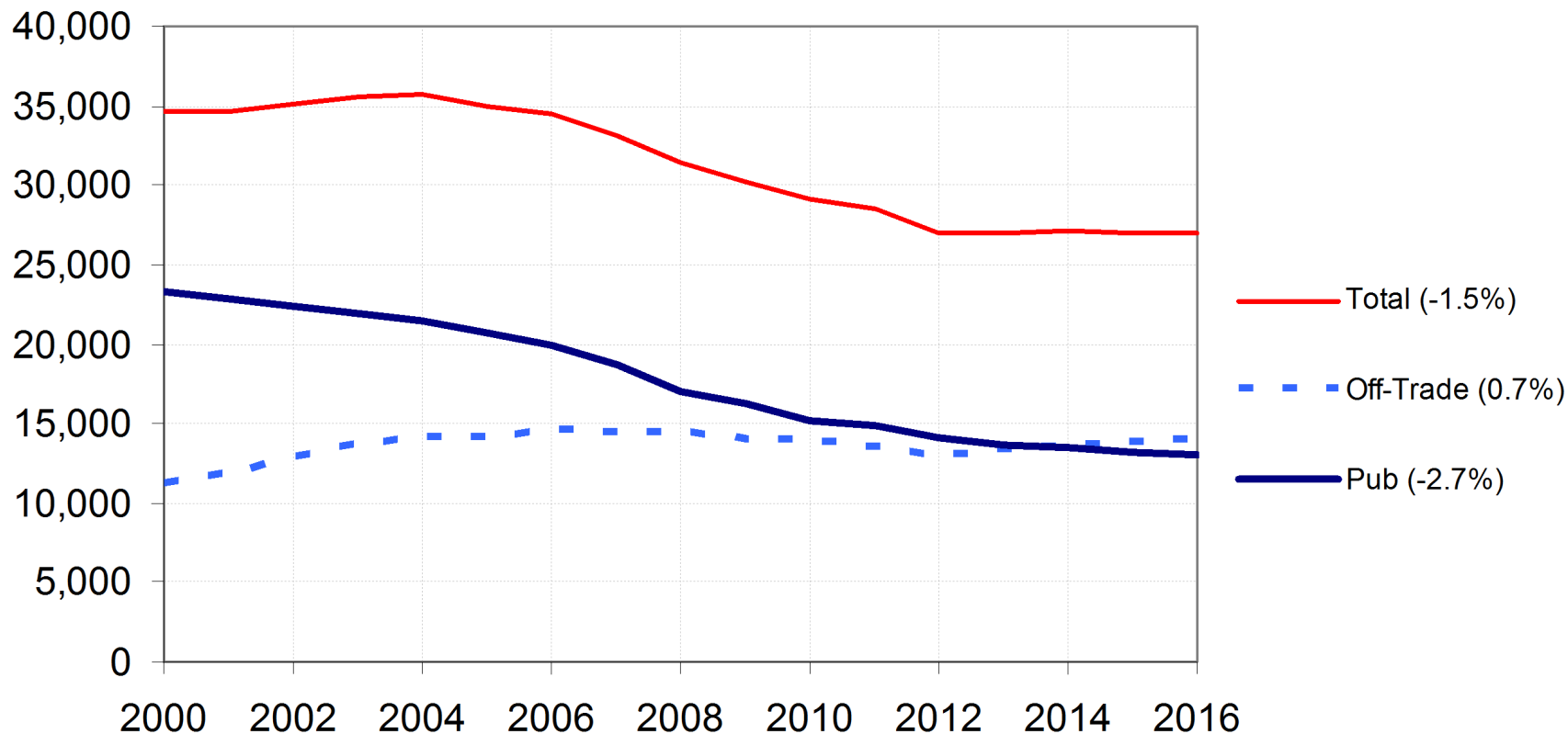
# Three ideas worth investing your time

1. Deep Value – Hargreaves Services (HSP:LON)
2. Cyclical – Fiat Chrysler Automobiles (FCA:IT)
  - At share price of €6, market cap is €9bn vs. €2.5bn adjusted EBIT
  - Mid-way through 5 year plan to eliminate debt and deliver €4 EPS
  - Marchionne a great capital allocator
3. Cheap Compounder – JD Wetherspoon (JDW:LON)



# UK beer consumption has declined, especially in pubs (-2.7% CAGR last 5 years)

## Annual Beer Sales (Last 5 Years CAGR)



Sources: British Beer & Pub Association

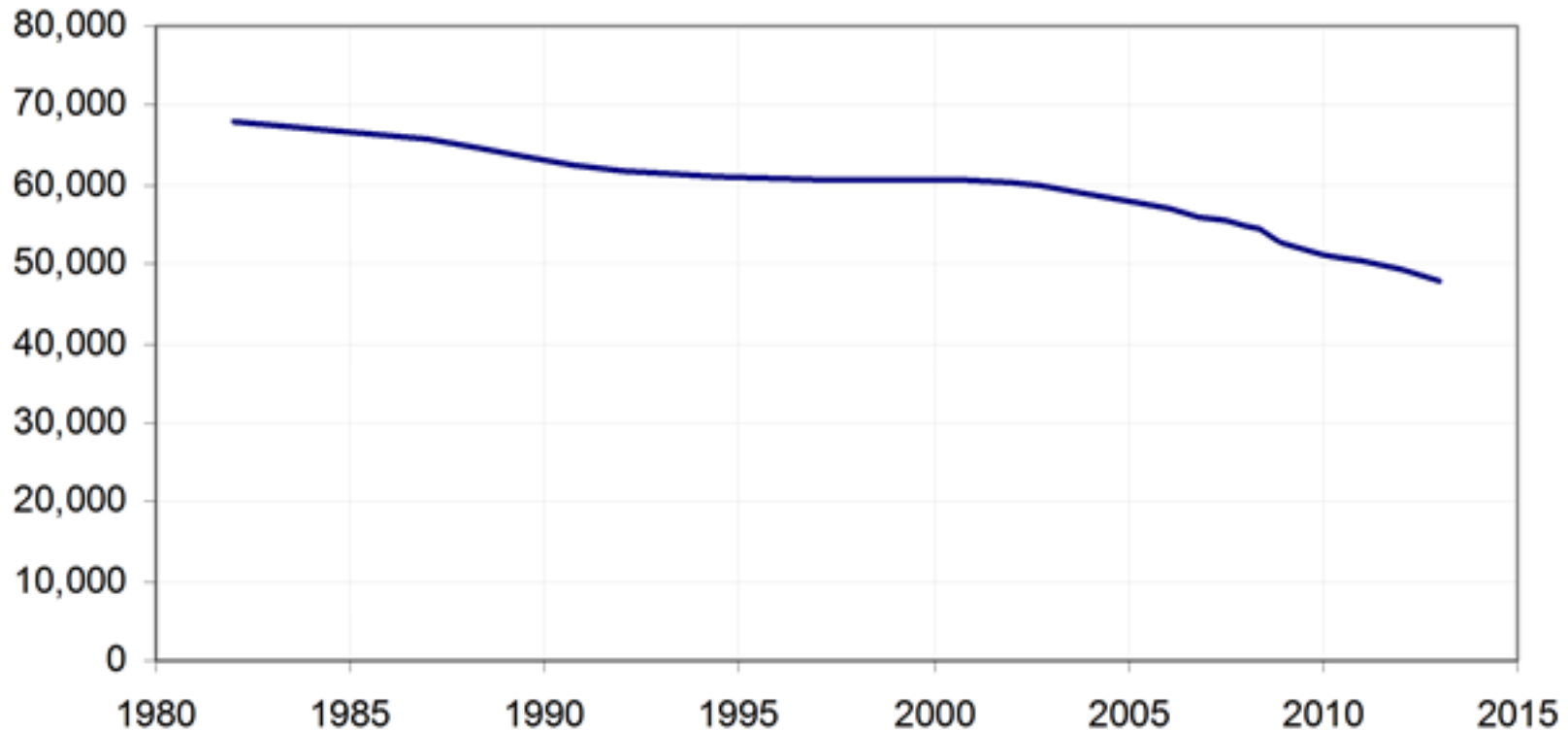
# The macro environment has been tough

- Weak middle-income wage growth
- Competition from supermarkets & expansion of casual dining
- Smoking ban from July 2007
- Higher minimum living wage from April 2016
- Government tax policy
  - Wetherspoon paid £705,000 in tax per pub in FY 2016 or 42% of sales

|                           |              |
|---------------------------|--------------|
| VAT                       | 311.7        |
| Alcohol duty              | 164.4        |
| PAYE and NIC              | 95.1         |
| Business rates            | 50.2         |
| Corporation tax           | 19.9         |
| Corporation tax credit    | –            |
| Machine duty              | 11.0         |
| Climate change levies     | 8.7          |
| Carbon tax                | 3.6          |
| Fuel duty                 | 2.1          |
| Landfill tax              | 2.2          |
| Stamp duty                | 2.6          |
| Premise and TV licence    | 0.8          |
| <b>Total tax</b>          | <b>672.3</b> |
| <b>Tax per pub (£000)</b> | <b>705</b>   |
| <b>Tax as % of sales</b>  | <b>42.1%</b> |

# UK pubs closed at a rate of 1.6% annually

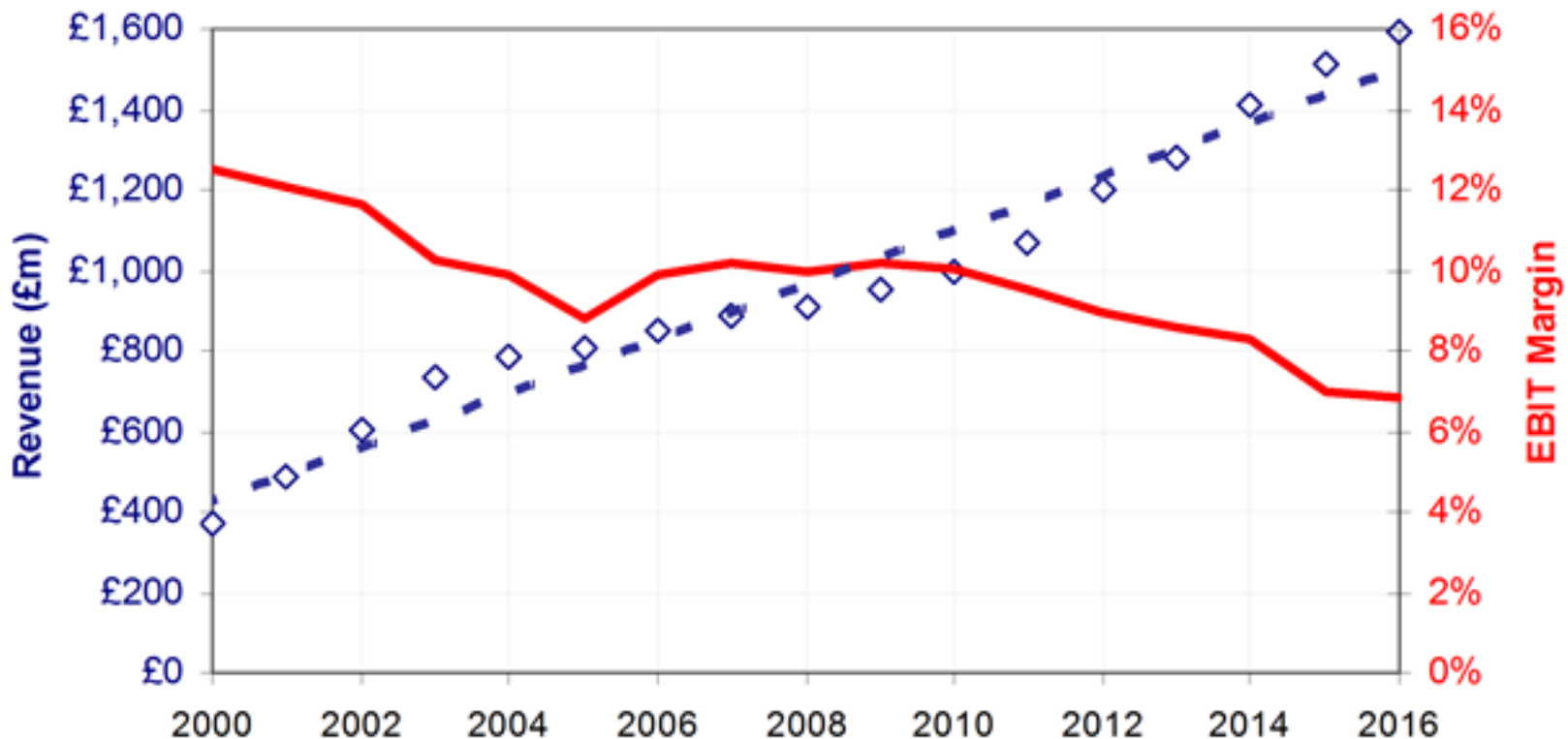
## UK Pub Numbers



Sources: British Beer & Pub Association

# Despite organic revenue growth of 8.3% CAGR, Wetherspoon margins declined

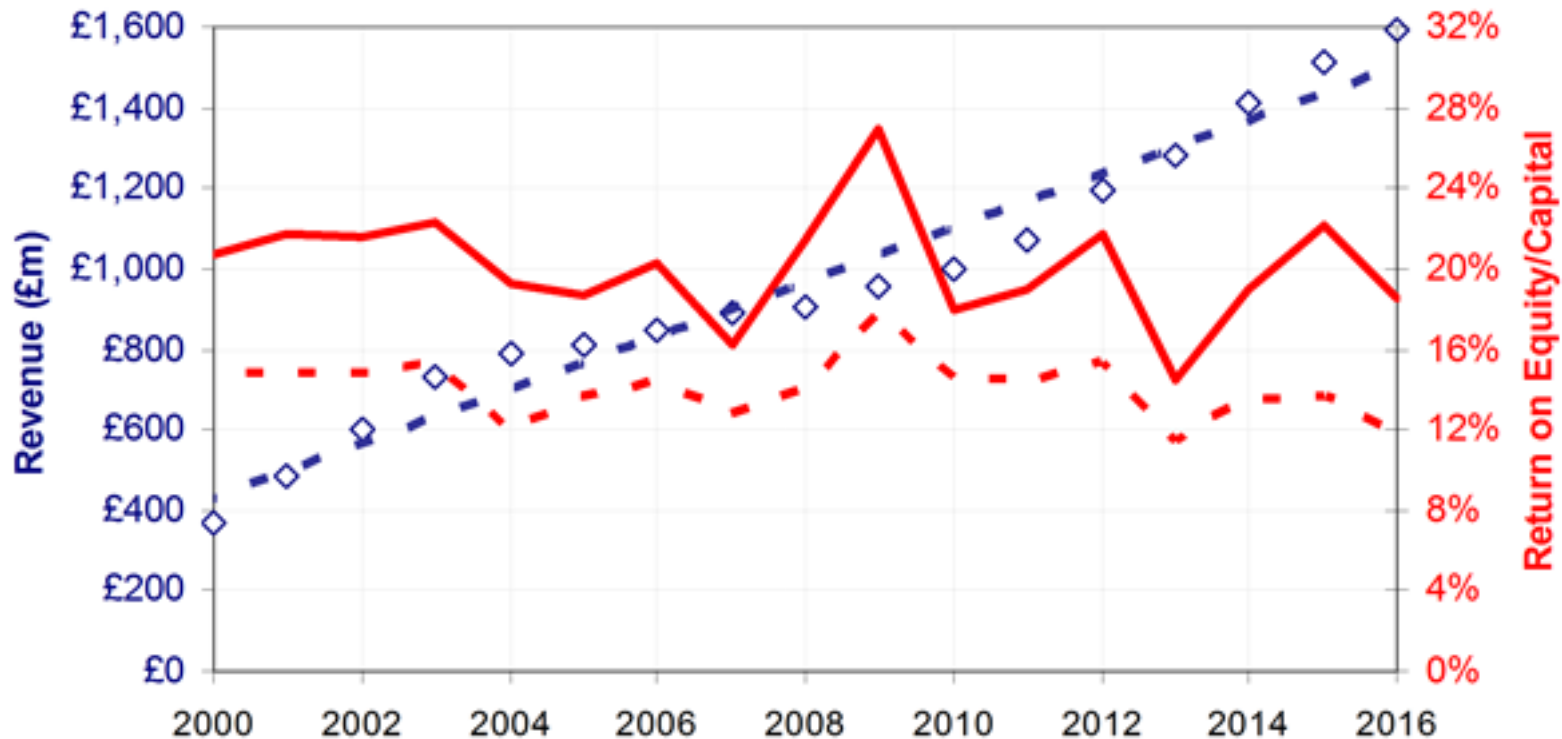
## Wetherspoon Revenue and EBIT Margin



Sources: Annual report, S&P Capital IQ, my adjustments & analysis

# BUT returns on capital remained high and stable

Revenue, FCF Return on Equity and FCF Return on Capital



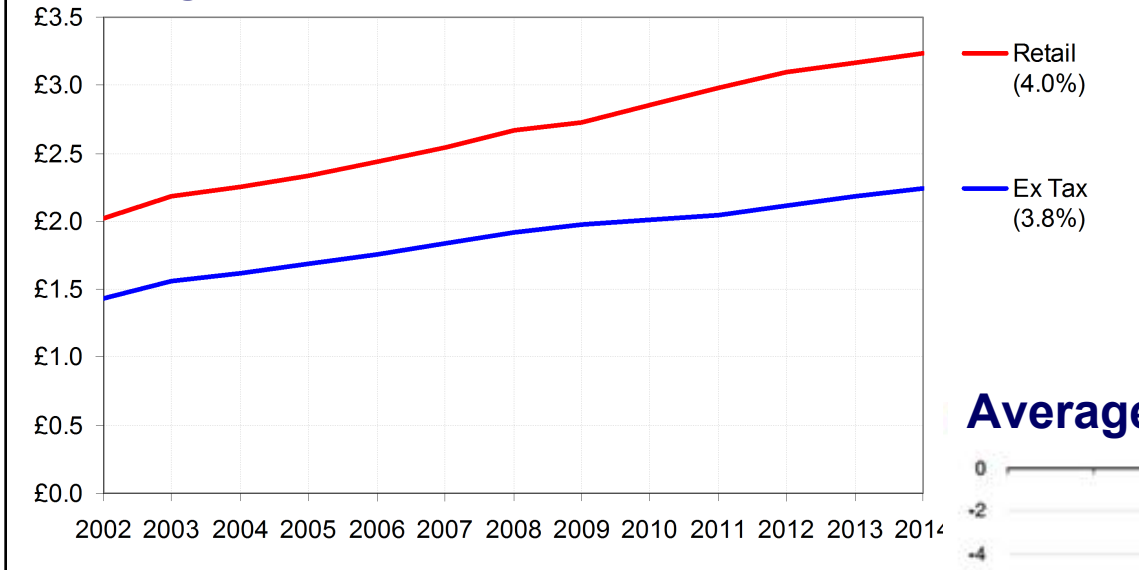
Sources: Annual report, S&P Capital IQ, my adjustments & analysis

# High returns on capital derive from a highly differentiated strategy

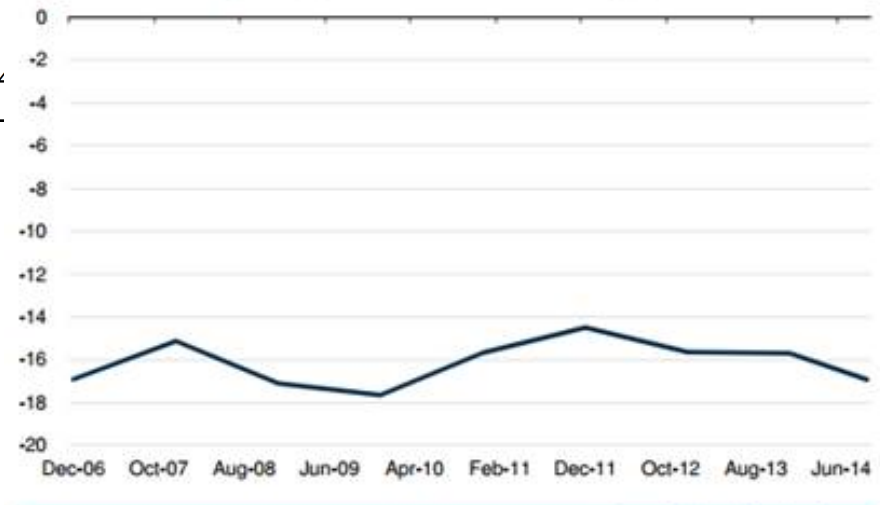
- Low price – high volume strategy for purchasing economies and maximising cash flow
- Pubs much larger than competitors', newer, retail conversions in high footfall locations, and 100% managed. Own 50% (outside London)
- Owner-manager mentality: Chairman/Founder owns 29.4% of shares
- Conservative: more aggressive depreciation than competitors, do not revalue pubs, much less debt, pay staff 20% more
- Outstanding capital allocation: Open new pubs if shares yield <12% FCF, otherwise buy-back shares

# And Wetherspoon has some pricing power

## Average Market Pub Price per Pint



## Average Wetherspoon Discount

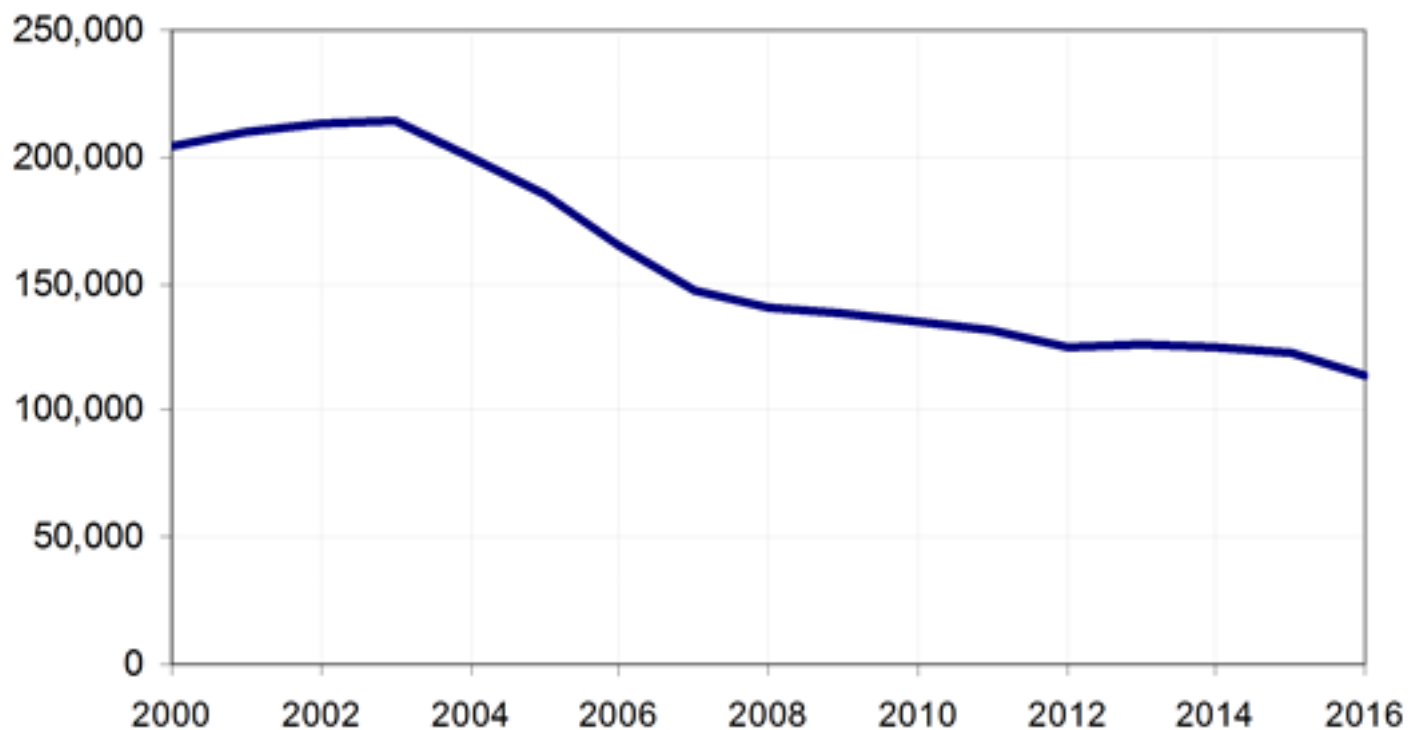


Sources: British Beer & Pub Association, Numis Securities, Oldfield Partners

Source: CGA, Numis Securities Research

# Management are outstanding capital allocators – repurchasing half the outstanding shares since 2003

## Wetherspoon Share Count ('000)

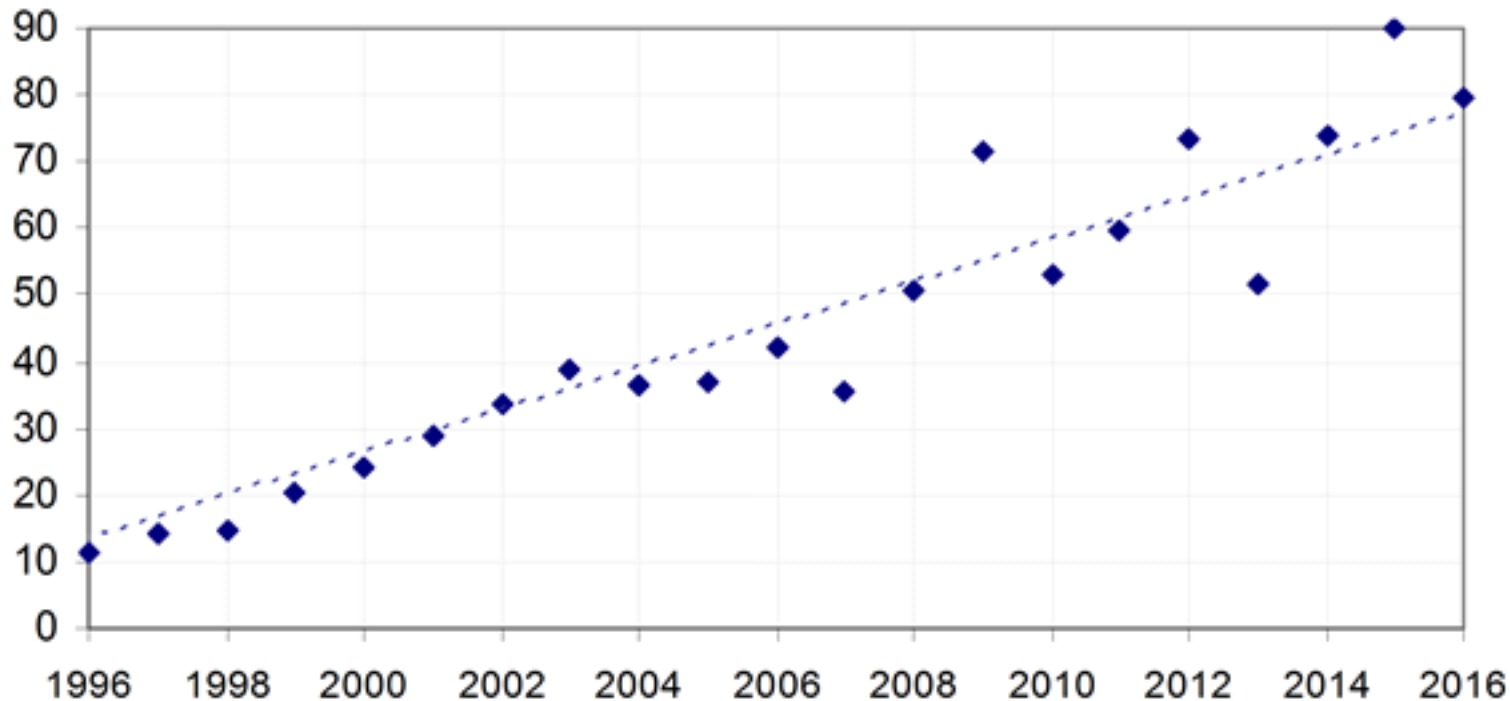


Sources: Annual reports



**At 950p, the shares offer a (normalised) free cash flow yield of ~9% growing at 5-7% pa (ex. buybacks)**

### Wetherspoon Free Cash Flow per Share



Sources: Annual report, S&P Capital IQ, my analysis

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# Disclaimer

- The material in this presentation is for information only and is not intended as a recommendation to purchase or sell any security
- I give no warranty as to its accuracy
- Do your own research

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