Langton Capital Limited

5 Nov 2014

JD WETHERSPOON (JDW): 832p
Q1 Update: Conference Call

Group says it's early in the year to be estimating margins; nonetheless, it has done so…

Year to end-July	PBT (£m)	EPS* (p)	PER (x)	DPS (p)	Yield (%)
2013 (A)	76.9	44.8	18.6	12.00	1.4
2014 (A)	78.4	48.6	17.1	12.00	1.4
2015 (E)	87.6	53.9	15.4	12.50	1.5

**Normalised, Source:* Company & Broker Estimates, 2015 upgrades likely

Q1 Update: 13w to 26 Oct 2014:

Following its update on Q1 trading earlier today, D Wetherspoon hosted a conference call for analysts and our comments thereon are set out below:

General Trading & Sales:

- Growth slowed in October but it's a little early to call this a trend; the group reiterated its belief that margins would be lower
- Not giving a split of food, drink + machines at this stage.
- Says 'better trading, improved staffing levels' etc. have underpinned sales rises. It's no particular day-part
- The whole of last year saw +5.6% or so meaning that comps are tougher; October was still positive
- Christmas? Most revenues are 'walk-ins'. Bookings, such as they are, are broadly in line with last year
- Geographic mix? City centres performing more strongly than suburbs.

Margins:

- Why down so much & so quickly? It's early in the year but the co. believed that it should guide
- Co. mentioned on a number of occasions that 'it's early days'; margin for the year could differ from guidance given
- Declines to say whether LfL profits are down or not.
- When will they level off? Co is focussing on sales and free cash flow

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Market Cap: £1,023m
12m range 680p 880p

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- Group is now lapping higher staffing levels associated with longer food-opening hours last year
- Cost inflation; how much is controllable? Most is 'continued investment for longer term health of the company' – wages, repairs.
    - This is consistent with comments from other operators, who are largely increasing margins
    - Group 'absolutely' believes that it will get a return on this investment
- The VAT issue referred to is being appealed by the ALMR – but the worst case is currently being accrued in JDW's numbers

Langton View: JDW has here mentioned on a number of occasions that it is a little early in the year for it to be pinning down margins.

Nonetheless, it has done so – and said that they will more likely be down than up.

Most – if not all – of the margin hit is down to factors (investments such as wage-rates, repairs etc.) that the company can control. The implication here is that the group could move margins up if it chose to do so. It clearly does not.

Longer term, JDW is raising further barriers to entry as regards its competitors. This may well be – and probably is – to the good but, in the short term, there will be disappointment that margins are falling once again.

There's little use spitting against the wind but, we would suggest, JDW remains a superlative operator and, though hardly cheap, its shares do not look unduly expensive at c14.5x earnings (on a reduced share price) with a yield of 1.6%. Having said that, the group has once again managed to disappoint on margins and the shares have come under downward pressure today. We remain of the view that any material weakness may present a buying opportunity.

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