Langton
Capital Limited

4 November 2015

JD WETHERSPOON (JDW): 776p
Q1 update – 13w to 25 October 2015:

Says 'sales have been slightly higher in the last 6wks' but highlights markedly lower margin…

Year to end-July	PBT (£m)	EPS* (p)	PER (x)	DPS (p)	Yield (%)
2015 (A)	77.8	48.6	16.0	12.0	1.5
2016 (E)	78.3	47.0	16.5	12.1	1.6
2017 (E)	79.6	50.0	15.5	12.3	1.6

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

Q1 Update - 13w to 25 October 2015:

JD Wetherspoon has this morning updated on trading for the 13w to 25 October 2015 and our comments thereon are set out below:

Trading:

- LfL sales are +2.4% in the full quarter having been up by only 1.4% in the first 6wks of the quarter
- That implies better trading, mathematically around 3.3% for the second half of the quarter
- Indeed the group says 'sales have been slightly higher in the last 6 weeks, which has coincided with the Rugby World Cup.
- Re margins, the group says the 'operating margin in the 13 weeks to 25 October 2015 was 6.2%, compared with 7.7% in the same 13 weeks last year.'
- It adds 'the lower margin was due to increases in the starting rates for hourly paid staff in October 2014 and August 2015, which totalled approximately 13%.'
- Recent trends are shown below:

Tab.1. Recent Sales Trends:

Financial Period	LfL Sales (%)
Full year 2008/09	+1.2
Full year 2009/10	+0.1
Full year 2010/11	+2.1
Q1 2011/12	+1.1

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Market Cap: £924m
12m range 692p 835p

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H1	+2.1
Q3	+2.0
Full year 2011/12	+3.2
Q1 2012/13	+7.1
H1	+6.9
Q3	+6.3
Full year 2012/13	+5.3
Q1	+3.7
Q2 (first 12w)	+6.7
H1	+5.2
Q3	+6.2
Full year 2013/14	+5.5
First 6w 2014/15	+6.3
Q1	+6.3
Q2 (12w)	+2.8
H1	+4.5
First 6wks H2	+1.6
13wks to 26 April	+1.7
39wks to 26 April	+3.6
11wks to 12 July	+2.9
Full year 2014/15	+3.3
6w 2015/16	+1.4
Q1	+2.4

Source: Company Reports

Balance Sheet, Debt & Outlook:

- The group has opened 3 new pubs since the start of the financial year and has sold 1.
- JDW says 'we intend to open approximately 15 pubs in the current financial year.' This is at the lower end of prior expectations
- The group confirms that 'following a review of our pubs, as previously reported, the Company offered 20 leasehold pubs for sale' but is adding it 'is now considering a small number of freehold disposals in the course of the financial year.'
- Re debt, JDW says 'the Company remains in a sound financial position. Net debt at the end of this financial year is currently expected to be slightly above the 26 July 2015 total of £601.1million.'
- Re the outlook, chairman Tim Martin says 'as we indicated in September, it is difficult to quantify exactly the factors which will influence our trading performance in the early stages of a financial year.'
- Mr Martin says 'increased labour costs are clearly an important factor for all pub and restaurant companies and may result in our annual profits being slightly lower than the last financial year.'

Conclusion:

- As mentioned previously, JDW is ahead of the curve on wages – but this is clearl at the expense of margin.
- The group increased the minimum hourly rate for staff by 5% in October 2014 and by a further 8% at the end of July 2015.

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- It says ‘both decisions were taken without the knowledge that the government was about to announce a new minimum wage, now called the "living wage".’
- Re current trading, there will be some downgrades. Today’s statement highlights good LfLs (relative to the industry) but lower margins and a reduced outlook.
- In the above, today’s RNS remains one in a series. The group’s shares may fall today and, as in the past, it would not be surprising to see the company buy into weakness

Langton View: JD Wetherspoon has remained true to form.

LfL sales have picked up but margin has taken another lurch downwards. Hence, even though we are only just finishing Q1, numbers will be adjusted accordingly.

Chairman Tim Martin has previously acknowledged that the economy is slightly better and sales are better. But non-director shareholders may wish to see this coming through to the bottom line and, at the moment, this is not happening.

As recently as 11 Sept, the group said ‘we continue to anticipate a trading performance similar to, or slightly above, that achieved in the last financial year.’ It knew at the time that it was putting wages up and LfL sales have improved yet guidance has now moved towards a small reduction in profits.

To be fair to the company, consensus forecasts were already for a small decrease in earnings this year. The group may earn around 48p in the year to July 2016 and perhaps 51p in the following year. This implies that the group’s shares are trading on a current year multiple of around 16.5x with a 1.6% yield.

This is not cheap, per se, but bulls (who could be getting a little exasperated) may focus on the fundamental strengths of the group and what looks should be higher margins next year whilst bears will suggest that the group may fail to deliver.

We would suggest that any material weakness should present a buying opportunity. Indeed the company itself is likely to see it that way. The group is a superlative operator, it has focused on accommodation, drink, food, further day-parts, coffee and a host of other growth areas and, though we acknowledge that this has to come through at the bottom line in order to justify our recommendation, we remain supportive of its shares.

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