Langton Capital Limited

20 January 2016

JD WETHERSPOON (JDW): 614.5p
Q2 update to 17 January Conference Call:

Tells long-suffering shareholders, somewhat unnecessarily, 'it's a bumpy road at times…'

Year to end-July	PBT (£m)	EPS* (p)	PER (x)	DPS (p)	Yield (%)
2015 (A)	78.3	48.6	12.6	12.0	2.0
2016 (E)	71.5	43.0	14.2	12.0	2.0
2017 (E)	75.0	45.0	13.6	12.2	2.0

**Normalized, Source:* Company & Broker Estimates, 2016 downgrades put through

Q2 Update – Conference Call:

Following its Q2 update, JD Wetherspoon this morning hosted a conference call for analysts and our comments thereon are set out below:

Trading:

- Margin weakness is due to planned wage hikes. The group says 'other cost rises have not been significant'.
- But why guide down on profits, what's new? Cost pressures have been 'broadly as expected'. That's not an answer but co says it has 'taken a slightly different view as to how costs will evolve'.
- Overall, supermarket pressure has been maintained. There is limited scope for price increases.
- Margin? This is an outcome rather than an input. If LfLs pick up, then the margin will edge up. Free cash flow remains very strong.
- Margin outlook? Not giving this number. Guiding more to profit. To hit numbers, they may be around current levels.
- Margin. Plenty of questions on this topic (of course) but co does point out that profits & EPS are still at (or now near) record levels.
- Inflation in the pub industry 'always seems to be higher than reported CPI'. Understood. Not helpful for margin, clearly.
- January trading? Won't give granular updates. If it was 'materially different' then it would have been highlighted.
- The weather? Mild weather was helpful but the flooding was clearly negative. Two pubs are still closed.

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Market Cap: £891.5m
12m range 674p 819p

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- Sees craft beer as an exciting and fast-growing area.

New Openings:

- Is 10-15 the 'new normal'? For the next 2-3yrs this may be the case. Freehold reversions have become a larger part of the capex profile.

Disposals:

- Disposals? These are hard to predict, particularly re timing. Some from June are still on the market. The will unlikely be sold by year end.

- What kind of profit contribution will be lost on sold units? There will be some foregone profits but these units are below average in terms of contribution. Retained sites in the area should pick up some if not most of this lost profit.

- The group had acquired units during the credit crunch for very modest amounts (circa half-full-cost) but there has been a degree of cannibalisation. Most sales, however, are because the group has outgrown the site.

- Profit on sale? Modest – but these are not poor units. Group does not have a 'tail' as such.

Debt:

- Why is debt rising if you are opening fewer pubs? Was £601m and will 'go up slightly'. Some costs from last year's openings are flowing through. There are some freehold reversions & maintenance capex remains significant. The above assumption is not accounting for material disposal proceeds.

Langton View: JD Wetherspoon's shares have initially responded rather negatively to this morning's news. At the time of writing, they are down some 9%.

Whilst understandable on the back of a 5% to 10% edging back in forecasts, we see this as an overreaction.

Having said that, JDW arguably does little to help the bulls when it comes to its share price. Its updates are brusque and (blessedly at 7am in the morning) brief and there tends to be a lot of comments to the effect that 'it is what it is'.

Taking the various influences into account, we see JDW's rating, down below 14x on even-downgraded next year numbers, as too low for such a good operator.

Timing is everything, of course, and today's fall is not a surprise. That said, we see real value and would take such weakness as a buying opportunity.

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