29 Nov 2016

WHITBREAD (WTB): 3488p
Equity & Capital Markets Day:

Whitbread says it has a 'clear plan for future growth…'

Year to end-Feb	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2016 (A)	487.7	238.7	14.6	90.4	2.6
2017 (E)	556.0	241.5	14.4	95.1	2.7
2018 (E)	590.0	256.0	13.6	101.4	2.9

Source: *Company & Broker Estimates*

Equity & Capital Markets Day:

Whitbread today made a series of presentations to shareholders, brokers & bankers in which it outlined where its businesses are today and how they intend to maintain growth.

The presentations came under the headings of Introduction, Property, Premier Inn and Costa. Over a period of 6hrs, a great deal of information was given out. We haven't attempted here to list the facts (these will be available on the group's Investor Relations website where the 180 slides will be posted) but have noted some of the key points below:

INTRODUCTION:

- Whitbread reports that its strategy & its 2020 milestones remain unchanged
- The group should save £150m in costs over 5yrs. It won't be breaking this number down any further

PROPERTY:

- Whitbread's property has a book value of £3bn but it 'is worth between £4.2bn & £5.1bn'. There is no lotting premium
    - This is on a yield of 4.5% to 5.5% - helped by the fact that Whitbread is its own tenant
- Some 63% of Premier is freehold. Even with the leaseholds in the pipeline, this will stay at c60%
- Sale & leasebacks should amount to £50m to £150m per annum
- Freehold makes financial sense at present – but it can lead to slower expansion. Debt can be had for c3% but rents will run at around 7% when the upward only nature of reviews is considered. Leaseholds are

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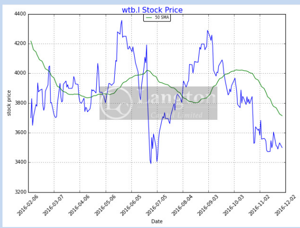

Market Cap: £6.4bn
12m range 3391p-4710p

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less flexible than freeholds in that the tenant cannot add extensions (or indeed tear them down)

PREMIER INN:

- Whitbread maintains that it is a value retailer. It will grow share, taking it primarily from independent operators.
    - Units hit maturity at 3yrs in provinces & by end-yr1 in London. Occupancy is c81% and 'could go to 82% or 83% over the medium term'
    - Branded budget is around 18% of the market today & should grow to c29% by 2020.
    - Disrupters should take c3% of the market by 2020
    - Says PI delivers on both quality and value. It can see opportunities 'beyond 100k bedrooms'. It has only 2k rooms to find to hit its 2020 target of 85k. Extensions are the lowest-risk route for expansion. It has 'line of sight' to 100k rooms
    - In markets where PI has <15% share, group says it can expand
    - Location is still the key deciding factor. This favours operators of scale, Premier Inn foremost amongst them.
    - London, though tough at the moment, is still seen as an area for growth
- Wishes to drive B2B, which comprises 'higher margin customers'. Business customers pay around £10 per night more than leisure customers
- Hub by Premier Inn gives access to high-cost areas. Occupancy is c94%
- Having restaurants adds £2 to £2.50 or so to REVPAR & directly leads to F&B spend. It allows the group 'to control the guest experience'. However, up to 85% of guests are not staying in the hotel
    - All Taybarns have now been converted to Brewer's Fayre. Whitbread believes Bar & BLOCK will be able to compete with other casual diners. Two should be open by the end of this week
- The German market is 'structurally attractive'. There are far more independents (c75% of the market) to provide share going forward.
    - WTB is committed to four sites in Germany. With 'more soon'. It may buy a small number of existing hotels.
    - Germany should be in profit by c6 hotels – but this will be partially dependent upon whether these are leasehold or freehold units.
- Behind the scenes, price management has evolved. The Automated Trading Engine ensures that prices rise as the day of occupation approaches.
    - Also behind the scenes, cost management is a major issue. Saving 1 minute per day per room on cleaning costs is worth £1m
    - Almost 90% of bookings come directly from PremierInn.com

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    - Re profitability, there are cost headwinds. Some of these will be mitigated by LfL growth & efficiency benefits (e.g. centralised purchase of cleaning products). However, margins will fall by 20-30bps next year.

- Other: Customers are more demanding but there are a small number of things that are vital when providing a 'value' product. This is where WTB concentrates its attention

- Question: If you're deemed to be good value (in PI), shouldn't you put your prices up? Company chooses not to do so. Network growth is where the money is and, for the moment, taking price will not help to drive growth in the size of the estate.

COSTA:

- Here convenience & quality remain key. There are a lot more good coffee shops out there than there were a decade ago but Costa 'has a great plan and has confidence that it will be able to execute it'
    - The competitor environment 'is fundamentally changed'. Costa 'has fallen behind in food'. But it has the heritage etc. to retain its lead. Admittedly per the company.
    - Group says it has 'significant further runway for growth' in the UK. It seems not to agree that there are enough already.
    - Group will 'innovate in coffee and food'. Perhaps a food acquisition or at least a closer partnership may be on the cards. There are some barriers (lack of a kitchen, not least)
    - UK now drinks more coffee than tea. But UK is still a modes consumer vs some other geographies such as Scandinavia, Germany, France etc.
    - Watch out, there are more 'craveable hero products' and 'tailored ranges of food' coming.
    - Group has 2,121 stores with 'clear line of site to 2,500'. There is 'significant white space'.
    - Costa has 44 Drive Thru sites with 13 of the top 20 Costa stores being in this category. Some are being considered in or next to Premier Inn sites
    - Estate is reasonably flexible with an average lease length (now) of around 12yrs and break clauses meaning that 10% of the estate could be exited per annum
        - The High St is the area that is currently showing least growth. Costa 'does not think the High St is dead, however'

- China: 395 JV stores. Been there 10yrs & have a 'solid base'. However, it's 'not been perfect', and 'there has been a lack of focus'.
    - Food in China will be area of focus. Will be 'British inspired'.
    - Group is no2 (behind Starbucks) in coffee in China – but it only has 395 stores vs 2,400 at Starbucks. Starbucks is raising the profile of the whole industry. Costa should be able to benefit from this
    - Q: Will stores be closed? Some will be closed. Leases are short, however, so this should not be too problematic.

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- Other international. Costa is no1 in Poland. Can drive the business in Mid East & S/E Asia.
- Costa Express has gone from 877 machines in 2011 to >6k. The original target for 2016 was only 3k machines. Shell is the largest partner. There are 3k machines on forecourts. International is performing well.
- Costa costs: There are headwinds. Group will attempt to mitigate. Margins will fall in 16/17 and a further 100bps will 'invested' in FY18.
    - Group believes some of its competitors may try to take price next year. Costa will then decide whether to move in this direction as well
    - Group may 'package' products – wrap & a coffee, for example.
    - Staff scheduling is being addressed. Also, delivery to store.

Langton Comment: Guest will have left the above presentations awash with information. Whitbread has strength in depth across its operations. It has good brands, there are growth opportunities and it is still a largely freehold business.

Its shares were perhaps a little stretched when they exceeded £54 in the middle of last year.

This partly because the coffee market, though not saturated (per the insistence, it must be said, of the operators), was becoming a little more so & the UK hotel market, particularly in London, was likely to face a more difficult market in 2016. In fact check out the crossroads where Clerkenwell Road meets Goswell Road. There's a Temptations, a Starbucks, a Pret, a Costa and a new Shoreditch Grind. There's also a Pizza Express, a pub, a wine bar and a salad bar – all selling coffee. That's at least 10 units within a few dozen yards.

Some of the market's concerns led to selling and WTB's shares are down c36% from their 2015 peak.

In addition, we have some concerns that hotel operators, including Premier Inn, have succumbed to facility creep meaning that facilities (and room rates) have risen over time. This has left something of a gap below them into which Tune, EasyHotel and others may be able to expand.

Furthermore, there are some macro headwinds. Costs are an issue and so, perhaps, will be demand. Though it is an affordable treat, coffee at £2.65 per cup with an ex-vat margin of 85% or so, may be vulnerable to a consumer slowdown.

Currently the group's shares trade on around 14.4x earnings for the year that ends in February. Certainly, growth is likely to be harder to come by and that 14.4x may not drop much for FY18. However, the group has good brands, good assets and growth potential overseas.

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