CREDO WEALTH

Coffee in bed

As fundamental investors, the shares we buy are fractional ownership in a real underlying business. Businesses are dynamic and those who run them are constantly re-evaluating their structure, to account for changing conditions. We don't have a crystal ball. We don't know exactly what management will do. We don't know what competitors will do. There is a lot we don't know. When we buy a stock, we try look through all this noise at what we think the underlying intrinsic value is. That isn't a clear number. It is based on our research and analysis of a wide range of possible future impacts and outcomes. When you have a long-term investment horizon, and confidence in real fundamentals underlying the decisions you make, we believe the intrinsic value becomes clearer over time.

Whitbread is a UK-listed hospitality company. They operate 785 hotels under the Premier Inn brand in locations across the UK, Germany and the Middle East. They also operate 2,400 coffee stores under the Costa brand across the UK and have outlets in 31 overseas markets. We bought in 2016 after the share price had sold off significantly, driven by a combination of management changes, weakening growth, and fears over Brexit.

The market was concerned about Costa's ability to perform under a possible UK recession scenario, brought about by leaving the EU. The potential of Starbucks (a comparable company) was better appreciated without this overhang. We were attracted by Whitbread's superior performance to peers during the financial crisis, structural growth opportunities in both businesses, and a solid balance sheet. We felt the pessimism presented us an opportunity.

In addition, we believed that Whitbread was trading at a discount to the sum of the individual parts of the business. There appeared limited strategic rationale for one set of management running the two quite different divisions. It had been suggested on multiple occasions that a break-up of the company would allow for more focussed management, enabling better performance from both divisions.

A separation could unlock the "conglomerate discount", often applied by the market to companies with assets that have limited strategic fit. This allows both businesses to trade at their fair value.

At the end of 2017 and the beginning of 2018, Whitbread rallied strongly after two activist investors disclosed that they had built stakes in the company (on expectations that they would push for a break-up of the business). Management announced that they would target a de-merger by 2020. This was slower than the market appeared to be hoping for. However, in late August management announced the sale of the Costa business to Coca-Cola.

Given that calculating intrinsic value isn't a perfect science, we like a margin of safety. The primary cushion we had when buying the stock was that Costa was undervalued relative to Starbucks. The price Coca-Cola paid suggests they agree. As a result of the substantial rally following the announcement, we believed that the upside of the break-up is fully accounted for now, and decided to sell our position in Whitbread.

Important notice

This document has been created for information purposes only and has been compiled from sources believed to be reliable. None of Credo, its directors, officers or employees accepts liability for any loss arising from the use hereof or reliance hereon or for any act or omission by any such person, or makes any representations as to its accuracy and completeness. This document does not constitute an offer or solicitation to invest or divest, it is not advice or a personal recommendation nor does it take into account the particular investment objectives, financial situation or needs of individual clients and if you are interested in any of the information contained herein, it is recommended that you seek advice concerning suitability from your investment advisor. Investors are warned that past performance is not necessarily a guide to future performance, income is not guaranteed, share prices may go up or down and you may not get back the original capital invested. The value of your investment may also rise or fall due to changes in tax rates and rates of exchange if different to the currency in which you measure your wealth. Credo Capital plc is authorised and regulated by the Financial Conduct Authority, is a member of the London Stock Exchange, and is an Authorised Financial Services Provider in South Africa.