Young and Co's Brewery plc – a super UKSA Visit and interesting case

by Malcolm Howard

We used to visit Youngs Brewery just before Christmas, where after the presentation we were given a superb Christmas party. Food and drink was on the house; you could consume all you wanted. Unfortunately a minority of members abused the company's generosity, so there was no Christmas party in 2016 and the meeting was moved to mid summer for 2017.

We were regally entertained at the Boathouse at Putney. After the meeting, the company laid on a superb buffet, together with a drink of your choice. A number of different wines were available and we were offered a top-up. Sensibly, after that the free bar was closed.

The presentation was given by Patrick Dardis, Chief Executive, who was assisted by Steven Robinson, Chief Financial Officer. It soon became obvious that what Mr Dardis did not know about the industry simply wasn't worth knowing! He explained that despite a difficult environment, the company had managed to achieve modest growth, a little better than major competitors.

Young's is a significant company and not the type you would expect on the Alternative Investment Market (AIM). I asked why the company was on AIM and he suggested it was to do with inheritance tax. In this context it is worthwhile looking at the tax benefits of AIM.

The Inland Revenue regards any company quoted on AIM as being 'unquoted'. Such companies are often primarily owned by families. What was happening was that when a significant shareholder died, often the business had to be sold to pay inheritance tax. To avoid this happening (in the particular circumstance described above) the government introduced 'Business Property Relief' the effect of which is that that such shares held in unquoted companies would not be subject to inheritance tax. Presumably, this is the reason that the major shareholders of the company moved onto the AIM market.

For shareholders, this is essentially the only tax benefit of holding AIM shares, unless they are held in ISA's, apart from three exceptions:

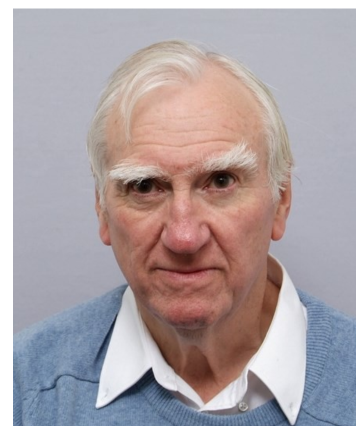
A shareholder owning 5% or more of the equity of a company in which he is an officer or employee is entitled to 'entrepreneur's relief' with the result that capital gains tax is reduced to 10%.

When purchasing shares in AIM listed companies there is no stamp duty, nor stamp duty reserve tax to be paid.

One of the reasons for setting up AIM was to give investors who had made investments under the Enterprise Investment Scheme (EIS) a chance to divest part or whole of their holdings. Therefore, anyone investing in a new AIM issue, where the shares had previously being held under EIS is entitled to 30% income tax relief. In addition the tax payer is entitled to loss relief. This means that if the investment turns out to be worthless then a high rate tax payer will only lose 38.5% of his money, while a standard tax payer will lose 56%. Young's Brewery does not fit into this category.

"A little learning is a dangerous thing; drink deep, or taste not the Pierian spring: there shallow draughts intoxicate the brain, and drinking largely sobers us again." (Alexander Pope (1688 – 1744). At the meeting a member chastised the speakers for only achieving 6% return on capital employed. The problem with this ratio is that it is misleading as it favours those companies not investing for the future. Worse, it fails to recognise the complexities of IFRS (fair value) accounting. 'Fair Value' is defined as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. So Young's assets are valued at 'fair value' and not what they paid for them. If we calculate the return on capital employed on this latter basis, then ROCE (in £'000) = 30 divided by 245 x 100 = 12.2%. Another

member complained that the company was not doing too well as the dividend yield was poor. Again, this was symptomatic of IFRS accounting and not a reflection of the company's performance.


Malcolm Howard

The majority of Young's pubs are freehold, which means they are valued at 'fair value'. Under IFRS rules, assets have to be valued even when it is difficult to assess such valuation. How many pubs are sold each year to provide a benchmark? If a pub was closed down, would the company get planning permission to built flats? The whole thing is speculative and, as shown below, the 'market' is not impressed. If you buy shares in Young's you are buying the current value of the assets, plus the future value of earnings. On this basis, the valuation might be:

Net asset value per share, excluding intangibles (p)	969.4
Less: valuation risk (p) (10% of IFRS figure)	(96.9)
Less: debt risk (p) 281.6 x 0.25 x 0.872	(61.4) *
Add: discounted value of earnings (p) 102.7 p (growth of 14%)	1,360 **
	2,171.1

* Because of economic cycles, prudent property companies maintain debt levels at no more than 25% of net assets excluding debt. Young's figure at 3 April 2017 was 21.8%. 21.8 divided by 25.0 = 0.872. I allow for 25% of debt per share to account for risk.

** 102.7p = EEPS, being cash generated from operating activities before movement in working capital, divided by the number of diluted shares. 14% growth is based on the compound growth achieved by the company between 2014 and 2017.

Now given the share price at the date the accounts were analysed was 1,315p a valuation of 2,171p looks quite a bit ridiculous. The reason for this is that the 'market' takes (quite rightly in my view) IFRS accounting with a large pinch of salt. We can assess a valuation based on accounting under UK GAAP:

Net asset value per share, excluding intangibles (p)	461.9
Less: valuation risk (p)	0.0
Less: debt risk (p) (281.6 x 0.25)	(70.4)
Add: discounted value of earnings (p) 102.7 p (growth of 4%)	948.0 *
	1,339.5

* Although the company had been achieving compound growth of 14%, the CEO told us that the market was tough and future growth above 4% would be difficult to achieve.

Now we have a valuation close to the market price.

When you buy shares in companies like Young's where they hold freehold property, then such property will have some value, unlike manufacturing companies (for example) where their assets might wear out and have no residual value. Accordingly, but are buying property in addition to future earnings. Some high growth companies do not pay any dividends, while some very low growth companies might pay high dividends. Young's could be considered somewhere between the two.

My conclusion is that this is a well run company with a fair market valuation.

by Malcolm Howard