HollAnd
Advisors

Holland Views – Limited Brands (Price: $61.25, MCap: $17.8bn)

A Pretty Picture

Researching Limited Brands' (L Brands) via its website in an open-plan office is likely to raise eyebrows. Let's just say the owner of the Victoria's Secrets and La Senza lingerie brands is an extensive user of provocative marketing techniques. Such distractions aside, it is our contention that L Brands is a superb retailer with ambitious but plausible growth targets, high returns (c.70%) and that rare attribute, a management team that truly understands capital allocation.

Our 'value' clients will be amazed that the seemingly exorbitant *headline* P/E multiple of 22x P/E did not deter us initially. On closer inspection we conclude it cheaper than that, dropping to c.18x Jan 2014 earnings. Still a higher price than we'd like to pay but isn't everything! If this business delivers on its ambitious growth plans, shareholder returns could still be c.20% pa compounded over the next five years, despite the lofty starting multiple.

<u>Fig.1: A very impressive retailing business: here in its own words</u>

- **We have global, category-leading brands with high emotional content that generate substantial income and cash flow**
- **Our overriding focus is on the substantial growth opportunity in North America**
- **We believe there is substantial opportunity for international growth and expect it to be accretive to the total company operating margin**
- **We are targeting a minimum of low double digit annual earnings growth and an operating income rate in the high-teens**
- **We continue to emphasize maintaining a strong cash and liquidity position while optimizing our cost of capital**
- **We will continue to manage inventory, expenses and capital with discipline**
- **We remain committed to returning excess cash and generating superior returns for shareholders**

Source: L Brands

In summary

- This is a long established business: L Brands was setup in 1963 by Leslie Wexner who today (at 76) remains actively involved as Chairman and CEO and holds 13% of the equity.
- Return on net tangible assets is c.70%, a level we think is the new normal for the business post the divestment of the lower-return apparel business in 2007.
- The company has outlined ambitious growth targets to double sales in the next five years largely within its North American borders but also through expansion of its capital efficient global franchises. This guidance suggests, a huge, 15% compounded EBIT growth.
- L Brands' use of cash generated and constant leverage ratios are excellent at boosting returns and per share value. L Brands is thus a rare beast – combining an excellent grasp of brand management and 'fast retailing' with a canny understanding of capital allocation.
- We are reminded of DIRECTV, Next and JD Wetherspoons – all great franchises - where also, most of the *investor* focus is on the operations but notably the capital allocation nous of the management - and its impact on shareholder returns – is often very under-appreciated.

Fig.1 above clearly outlines, in its own words, the company's impressive strategic plans. Fig.2 overleaf shows the track record of returns which give credibility to these claims.

Behind every great company is…

The difference between a good company and a great company can often be down to the relentless obsession, passion and ability of the person at the top. L Brands looks one such great company and Leslie Wexner joins Messrs Wolfson, Walton, O Leary, Martin, White, Bich, Hayek (Sr), Soames et. al. in the Holland 'Management Hall of Fame'!

We highly recommend reading some of Mr Wexner's shareholder letters in their entirety in our accompanying appendix. Here is a taster:

> (Upon being asked how do you define your business?) "*I would ask myself every year: are we getting better at a skill that's obsolete. When you do what we do, you're a specialty retailer, the really hard question isn't what else you do. It's what you stop doing"*
>
> *…"we have a clear opportunity to double the business in the next 5 years - why? We simply have the world best brands…doubling business means doubling volume and profitability in every store... I believe we can double our volume through store productivity in North America alone"*
>
> *"…in 2012 we returned more than $2bn through repurchases and dividends....our ability to do so - and to do so consistently – is a key measure of our success"* – Leslie Wexner, Chairman and CEO (emphasis ours)

The central point for us here is that this is a business that is led very well from the top. It is also a business that is being run-hard with ambitious, but well thought-out goals. This means constant self-evaluation (often resulting in exiting under-performing businesses), tough growth targets, intense productivity scrutiny and not least, savvy use of capital. We applaud it all and think shareholders ought to do the same.

Why management experience matters

We have now encountered entrepreneurs in all shapes and sizes (literally) and recently our thoughts turned to sailing analogies. That there are many young, energetic business founders who have achieved brilliant things quickly, there is no doubt. Many are highly impressive and preside over businesses growing at staggering rates (Facebook et al). They are often feted by all and their companies valued accordingly. Such managers might be compared to the Olympic winning clingy sailor who is on the top of his game for 4, 8, or in extreme even 12 years.

But there are other CEOs/founders who are older (and wiser) as a result of their own and others' mistakes. Some may have less energy than in their youth, but possess much greater wisdom as they have seen the business and real world revolve many times. These we liken to a ship's wily older captain.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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