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Breakfast, Lunch & Dinner - Is Greggs a Winner?

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Having majored on large cap value investments in my recent newsletter picks (Imperial Tobacco - May, NatWest Group - January) I want to move across to mid-cap growth for this issue where we shall have to pay more for the earnings on offer but where the growth prospects are stronger. Buying a share that has high free cash flow from its activities and ability to pay fat dividends is all well and good but there is a risk they stagnate and the dividend becomes the principal element of the return or, worse, becomes a millstone around management's neck, choking off investment that could grow the business. Hence, to have a portfolio of diverse outcomes, it is helpful to embrace some companies that have a credible growth plan and back it up by investing much of the company's income back into that plan. Such companies tend to be younger, less mature and smaller. Thus, it is no great surprise that the FTSE 250 has several such candidates amongst its ranks. The mid-cap index also tends to be more focussed on the UK, as is the case with this month's stock pick: **Greggs**.

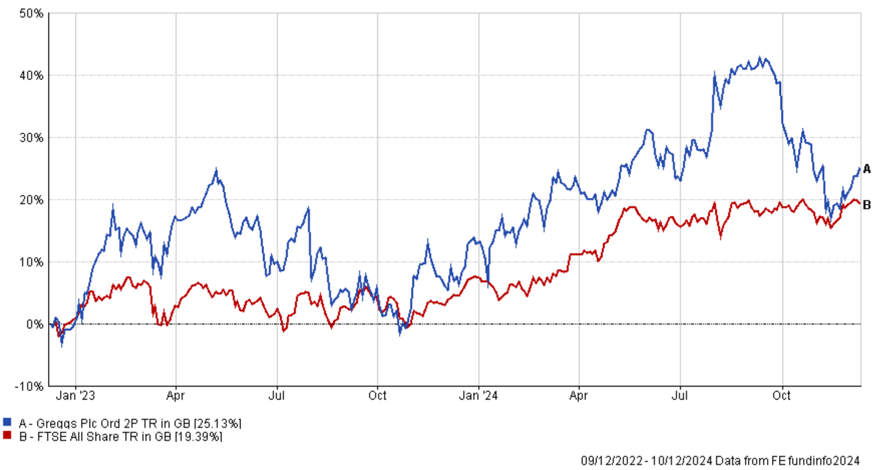
In a little over 75 years the company has grown from John Gregg's bakery in Gosforth just outside Newcastle to become a 2,559 strong store estate serving hot or cold bakery goods and sandwiches, employing in excess of 32,000 people including franchises. What may appear to be a simple business is in fact a fast-moving retail phenomenon with skilled management that jockeys for position on the UK's high streets with McDonalds and the big coffee chains on the one hand and small independent sandwich shops on the other.

The menu is basic compared with some competitors, but it competes strongly on price and availability of hot food and drinks. Half-way through a 5-year growth programme, the strategy is to continue to open new stores including via franchises in education and transport facilities but also refurbish and relocate existing stores and extend opening hours into the evening. The compact kitchens behind the counter can handle breakfast, lunch and evening foods, from bacon rolls to pizza slices backed by significant 'unseen' efforts in supply chain and preparation.

The board sets achievable targets that nevertheless stretches a management that has a handy knack of attainment. The City has noticed, and Greggs has a list of institutional shareholders spanning many of the major fund management groups.

Up to the end of September like-for-like sales in the 2016 company managed shops were up 5% compared to the previous year. At this third-quarter stage in the company year, and despite suffering cost inflation of around 4% amongst the economic headwinds, the board said the company's results should be in-line with prior expectations. We can translate this as being indicative of full year sales of just over £2 billion, earnings per share growth of just under 10% and the ability to pay a dividend of around 70p according to consensus estimates from City analysts.

This board announcement came prior to the Budget, which upset many consumer facing companies that have large, low paid workforces. The twin rises in employers National Insurance payments and minimum wage will hit the bottom lines of many of the big retail businesses we interact with as consumers. It has caused quite some controversy, and we have seen Greggs share price dip. Over the period since their third quarter outlook at the beginning of October the share price has fallen from 3124p to 2742p at the time of writing.



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Noting the Financial Director's recent remarks at a conference, I think we can allow ourselves to think this is an opportunity to buy shares that are normally expensive at a cheaper level. In a post-Budget Q&A he predicted cost inflation of c5-6% in 2025, which Greggs expect to recover via pricing. The NI increase is equivalent to 1% within the projection. The whole industry is expected to behave rationally and pass on cost inflation rather than try to absorb it. Therefore, I deduce the negative effect for Greggs to be the extent to which a 5% hike in consumer pricing across the industry destroys demand or whether they are net beneficiaries of consumers trading down.

Greggs' offer of convenience and value pricing has meant that they perhaps did not need to be early adopters of online ordering and delivery but this is also starting to change and should the trend move that way they have the scope to accommodate it.

Adversities like this projected hike in labour costs might not be welcome but they do tend to do most damage to the smaller operators who do not have the strength to flex their business model, ability to invest in processing equipment or put pressure on suppliers. This is why Greggs has been able to expand in the period since covid-19 as independent sandwich shops closed, unable to re-establish their businesses in city centres hollowed out by the work from home trend. Greggs is big enough to push back on landlords and business rate assessments and take advantage of vacant sites to reposition shops in better locations.

Optimism rewarded

I would like to use a little space to revisit something I mentioned in August 2023. Many of you bought shares in **Scottish Mortgage (SMT)** following my feature when it was priced around 660p. That proved to be the nadir and since then the shares have recovered quite some way. As I write they are 977p and it is sensible to consider what has brought us so far, so fast.

SMT had seen recent change at board level and manager level when several stock level news stories were acting as a headwind to the portfolio. Up popped US activist investor Elliott to put the squeeze on strategy noting a share price that had moved to a wide discount of 22% relative to net asset value. My thesis that Scottish Mortgage was holding stocks that would be in the vanguard of coming market trends has somewhat come true.

It still has exposure to Nvidia and Tesla which have grown further but it has become clear SpaceX is hugely valuable as an unlisted stock and we are still hoping Stripe scores a big IPO price.

I said stocks like SMT are *ambitious, future looking and pay little regard to short term market sentiment.* I would say the same now and continue to hold some of its shares but I fancy trimming the holding and taking some short-term profit would also be sensible because you may see the odd setback before some of the as yet under-appreciated newer smaller holdings bear fruit.

Discrete 12 month Performance (%)	Nov 24	Nov 23	Nov 22	Nov 21	Nov 20
Scottish Mortgage Investment Trust	30.7	-5.3	-48.1	36.3	108.0
FTSE All Share	15.8	1.8	6.5	17.4	-10.3

Source: FE Analytics