# *Financial statements*

**In this section**

## Report on the audit of the financial statements

### Opinion

In our opinion:

- the financial statements of Mitchells & Butlers plc (the 'Company') and its subsidiaries (the 'Group') give a true and fair view of the state of the Group's and of the Company's affairs as at 29 September 2018 and of the Group's profit for the 52 weeks then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 'Reduced Disclosure Framework'; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the Group income statement;
- the Group statement of comprehensive income;
- the Group and Company balance sheets;
- the Group and Company statements of changes in equity;
- the Group cash flow statement;
- the related notes 1 to 5 of Group financial statements; and
- the related notes 1 to 10 of the Company financial statements

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 'Reduced Disclosure Framework' (United Kingdom Generally Accepted Accounting Practice).

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Summary of our audit approach

| | |
|---|---|
| **Key audit matters** | The key audit matters that we identified in the current year were:<br>• Valuation of the pub estate<br>• Onerous lease provisions<br>• Compliance with debt covenants |
| **Materiality** | The materiality that we used for the group financial statements was £8.8m which is approximately 5% of profit before tax before separately disclosed items. |
| **Scoping** | A full scope audit has been performed in respect of the UK business, consistent with 2017. |
| **Significant changes in our approach** | There has been a new key audit matter identified in relation to compliance with debt covenants. There have been no other changes in the key audit matters included in our audit report since 2017. This is consistent with the fact that the operations of the Group are largely unchanged from the previous year. |

## Conclusions relating to going concern, principal risks and viability statement

| | |
|---|---|
| **Going concern**<br>We have reviewed the Directors' statement in Section 1 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.<br><br>We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit. | We confirm that we have nothing material to report, add or draw attention to in respect of these matters. |
| **Principal risks and viability statement**<br>Based solely on reading the Directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the Directors' assessment of the Group's and the Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:<br>• the disclosures on pages 38 to 42 that describe the principal risks and explain how they are being managed or mitigated;<br>• the Directors' confirmation on page 39 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or<br>• the Directors' explanation on page 42 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.<br><br>We are also required to report whether the Directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit. | We confirm that we have nothing material to report, add or draw attention to in respect of these matters. |

## Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

There has been a new key audit matter identified in the year in respect of compliance with the EBITDA to debt service restricted payment test. Given the challenges in the industry with high levels of competition and inflationary cost pressures, there remains a risk that the Group does not achieve the required level of profit to meet the EBITDA to debt service restricted payment test.

| Key audit matter description | How the scope of our audit responded to the key audit matter | Key observations |
|---|---|---|
| **Valuation of the pub estate** | | |
| As set out in section 3.1 the value of the estate is £4,230m (2017 £4,230m).<br><br>**Freehold and long leasehold**<br>The accounting policy adopted and judgements used are described in section 3.1 to the financial statements.<br><br>This is considered to be a key audit matter due to the judgements inherent within the valuation exercise and the range of acceptable judgements. The total net book value of revalued properties as at 29 September 2018 is £4,230m (2017 £4,230m). The revaluation exercise performed in the year has resulted in a net decrease of £33m versus carrying value (2017 £23m), which includes an impairment charge of £28m (2017 £51m) recognised in the income statement. The Group's accounting policy sets out that the market value is determined using factors such as estimated fair maintainable trading levels and estimated multiples which are derived for each of the Group's trading brands. Approximately 20% of the freehold and long leasehold estate has been inspected by the Group's external valuers, with the result of the inspection informing the brand standard multiples which are then extrapolated across the remainder of the estate.<br><br>In specific circumstances where this approach does not fairly represent the underlying value of the property, for example if a site is loss making, a spot valuation is applied.<br><br>Where sites have been impacted by expansionary capital investment in the preceding 12 months, the valuation of those properties is held at the 30 September 2017 valuation plus capital expenditure less depreciation in 2018. Sites that have been open for more than three periods (2017 three periods) are reviewed for impairment.<br><br>**Short leasehold**<br>The accounting policy adopted and judgements used are described in section 3.1 to the financial statements.<br><br>The total value of short leasehold properties as at 29 September 2018 is £156m (2017 £170m). Judgements in relation to expected trading levels, whether the site has the potential to be turned around and discount rates are applied when calculating short leasehold property impairments. The Group recorded an impairment charge of £15m (2017 £17m) in the year. | We worked with our property valuation specialists and management's external advisers to challenge the methodology and underlying assumptions used in the freehold and long leasehold pub estate valuation. This included:<br><br>• confirming the appropriateness of the estimated FMT being used to value the properties;<br>• obtaining evidence to support the appropriateness of the valuations of the inspected estate when benchmarked to transaction activity in the licensed retail property market;<br>• testing the application of the multiple derived from the valuation of inspected properties to the rest of the estate;<br>• completing a retrospective review of the valuation of sites subject to expansionary capital investment in the prior year to identify the success of returns on investment;<br>• reviewing the appropriateness and completeness of any spot valuations made; and<br>• obtaining evidence to support the future projected income used in the impairment reviews for sites which have been impacted by expansionary capital investment in the preceding 12 months.<br><br>Additionally we:<br><br>• assessed the design and implementation and tested the operating effectiveness of controls in relation to the valuation of the freehold and long leasehold estate. | We are in agreement with the methodology chosen and the assumptions adopted to revalue the pub estate and conclude there appears to be no bias in the valuation. The multiples adopted across the estate are within a reasonable range. We concur that the valuations are suitable for inclusion in the financial statements. |

| Key audit matter description | How the scope of our audit responded to the key audit matter | Key observations |
|---|---|---|
| **Valuation of the pub estate** continued | | |
| **Focus areas**<br>Given the amounts capitalised and the risk associated across the freehold, long leasehold and short leasehold sites we have focused our procedures on the assessment made by management of:<br>• the appropriateness of the fair maintainable trading levels and brand multiple assumptions applied to the freehold and long leasehold estate on a site by site basis;<br>• the valuation of freehold and long leasehold sites impacted by expansionary capital, challenging the need for any impairment of property, plant and equipment required at an individual outlet level; and<br>• the requirement for any impairment in respect of the property, plant and equipment held in the short leasehold estate at an individual outlet level.<br>In addition, due to the level of subjective judgements involved in respect of multiple and fair maintainable trade assumptions which are inherently uncertain, we have identified a potential risk of fraud in this key audit matter. | We challenged the assumptions used by management within the impairment reviews performed for the short leasehold estate and freehold and long leasehold sites impacted by expansionary capital. This included:<br>• obtaining evidence to support management's assertion that short leasehold properties can be successfully turned around where properties have not been impaired due to management's expectation that the performance of the properties will improve. This included obtaining evidence to support management's turnaround plans and performance of a retrospective review considering the success of historic turnaround plans;<br>• obtaining evidence to support management's expected performance of sites post investment of expansionary capital and a retrospective review of prior year sites where expansionary capital was incurred;<br>• testing the integrity of the information used within the model by agreeing inputs back to source data including historical results and lease terms; and<br>• assessing the appropriateness of the discount rate through recalculation and performing sensitivity analysis.<br>Additionally, we assessed the design and implementation and tested the operating effectiveness of controls in relation to the short leasehold impairment review. | |
| **Onerous Lease Provisions** | | |
| As set out in section 3.3, property provisions are £43m (2017 £42m) of which £41.9m (2017 £41.9m) relates to onerous lease provisions. The accounting policy for provisions is set out in section 3.3.<br>Loss-making short leasehold properties are reviewed by management to determine whether an onerous lease provision is required. Judgements in relation to expected trading levels, the appropriate lease term over which to provide, the potential opportunity to exit the leases early and the appropriate discount rate to use are applied when assessing the level of onerous lease provision required. Therefore we have identified a potential risk of fraud in this key audit matter.<br>**Focus areas**<br>Given the size of the leasehold estate there is a risk that where a site is underperforming the cash flows may not be adequate to cover future lease obligations, resulting in the requirement for an onerous lease provision for the unavoidable cash flow. We focused on the completeness of the onerous lease provision by assessing the judgements used in arriving at the level of the provision for each site. Furthermore, we also focused on sites where a turnaround or exit plan is in place. | We performed the following procedures to respond to the key audit matter:<br>• we assessed the appropriateness of the classification of property provisions provided in the period as a before separately disclosed item in accordance with IAS 1 Presentation of Financial Statements;<br>• we checked that all leasehold sites were considered in management's process to identify sites which were potentially subject to onerous leases;<br>• where onerous lease provisions have not been recognised, despite historical results indicating that a provision may be required, we obtained evidence to support management's assertion that properties can be successfully turned around. This included assessing the success of previous actions undertaken by management to turn around similar sites;<br>• we tested a sample of loss making short leasehold and unlicensed properties to create an expectation of the appropriate level of onerous lease provision for each property within our sample and compared our expectation with the level of onerous lease provision for each property;<br>• we assessed the appropriateness of forecast EBITDAs taking into consideration the cost saving and sales opportunities identified by management following a benchmarking exercise;<br>• we tested the integrity of the information used within the onerous lease provision calculation by agreeing inputs back to source data including historical results, and rental commitments; and<br>• we assessed the appropriateness of the risk free discount rate used through comparison to appropriate external benchmarks.<br>Additionally we assessed the design and implementation and tested the operating effectiveness of controls in relation to the calculation of the onerous lease provision. | We agree that the level of onerous lease provision is within a reasonable range and that the presentation of the movements in onerous lease provision is in accordance with IAS 1. |

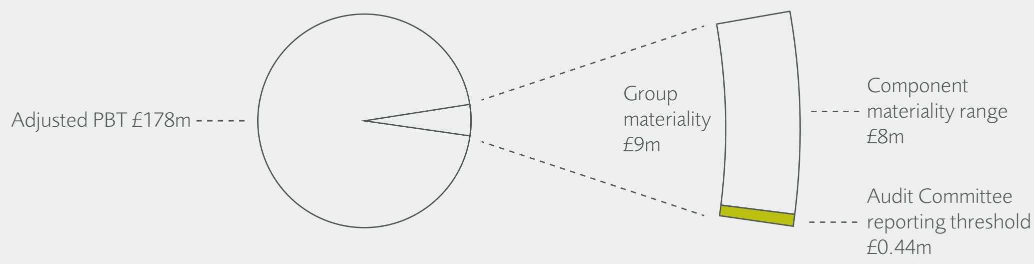
| Key audit matter description | How the scope of our audit responded to the key audit matter | Key observations |
|---|---|---|
| **Compliance with debt covenants** | | |
| The primary source of borrowings for the Group are secured loan notes of £1,784m at 29 September 2018. This debt is secured on the majority of the properties owned by the Group (properties held within a subsidiary Company Mitchells & Butlers Retail Limited). The Group also has £150m of unsecured credit facilities. There are covenants attached to both the secured loan notes and the unsecured revolving credit facilities.<br><br>Given challenges in the industry with high levels of competition, inflationary cost pressures and increasing uncertainties around Britain exiting from the European Union, we identified that the forecasting of EBITDA during the long-term viability period is subject to significant judgements and estimates.<br><br>The key risk identified is the Group's ability to meet the forecasted EBITDA over the longer-term viability period for the financial covenants attached to the secured loan notes. This test is measured at each quarter end date for Mitchells & Butlers Retail Limited.<br><br>Debt covenants are further disclosed within Note 4.2 of the Group Financial Statements, as well as being disclosed in the Long-Term Viability Statement. | We performed the following procedures to respond to the key audit matter:<br>• assessed the design and implementation of controls in relation to the management review of Budget and covenants calculations;<br>• reviewed management's going concern and longer-term viability assessment, by challenging management to understand the key drivers forming the basis of the EBITDA forecasts and challenging the assumptions used in the base case scenario using industry forecasts, historical performance and our understanding of the business;<br>• challenged the appropriateness of the reasonably possible sensitivities used in management's downside scenario over the longer-term viability period;<br>• reviewed and challenged management's key assumptions by reference to independent industry sources and relevant supporting evidence and sensitising the impact these have on management's assessment of the profitability;<br>• considered the feasibility of the mitigating actions that management have at their disposal should the financial covenant test be close to being breached; and<br>• reviewed the disclosures on going concern and longer-term viability to confirm that they are consistent with the knowledge we have acquired during the course of our audit and to confirm that the disclosures are consistent with the overall requirement for the Annual Report to be fair, balanced and understandable. | We have considered reasonably possible downside scenarios and we have identified that adequate headroom exists. Furthermore, we are in agreement that should a covenant be close to being breached, management have further actions that could be undertaken in order to prevent such a breach occurring. Therefore, we concur with the management assumptions made in relation to going concern and long-term viability of the Group and the resulting disclosures included in the long-term viability statement. |

## Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

| | Group financial statements | Company financial statements |
|---|---|---|
| **Materiality** | £8.8m (2017 £8.75m) | £8.5m (2017 £8.7m) |
| **Basis for determining materiality** | Approximately 5% (2017 5%) of profit before tax adjusted for net profit arising on property disposals, movements in the valuation of the property portfolio and short leasehold impairment and separately disclosed pension legal costs. Adjusted items relate to separately disclosed items in note 2.2 (2017 profit before tax adjusted for net profit arising on property disposals, movements in the valuation of the property portfolio and short leasehold impairment and the separately disclosed onerous lease provision charge). | Parent company materiality equates to 0.4% of net assets, which is capped at 97% of Group materiality. |
| **Rationale for the benchmark applied** | Profit before tax before separately disclosed items is a key measure used by the Group in reporting its results to allow a better understanding of the adjusted trading of the Group and is also a key measure considered by users of the accounts. | The parent company does not trade or exist for profit generating purposes so materiality has been determined using net assets. |



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £440,000 (2017 £437,500), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

## An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed a full scope audit in respect of the UK retail operating business which accounts for 99% (2017 99%) of the Group's total assets, 96% (2017 97%) of revenue and 96% (2017 98%) of operating profit. This audit work was performed directly by the Group audit engagement team, who also tested the consolidation process. Given the relative size of the German business ('ALEX') we consider the UK business provides sufficient audit assurance over the Group balances. This approach is consistent with 2017. At the parent entity level we also tested the consolidation process, as well as the parent balance sheet to parent company materiality.

In responding to the assessed risks of material misstatement, the audit engagement team sought to place reliance on the operating effectiveness of the Group's controls in relation to revenue, food and drink expenditure, property, plant and equipment, onerous lease provisions and valuation of the pub estate.

Our audit work on the UK business was executed at levels of materiality applicable to each individual entity which were lower than Group materiality and ranged from £1 to £8.5m (2017 £0.27m to £8.7m).

| | Full audit scope | Review at group level |
|---|---|---|
| Revenue | 96% | 4% |
| Profit before tax | 96% | 4% |
| Net assets | 99% | 1% |

## Other information

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the Directors that they consider the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the Directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

**We have nothing to report in respect of these matters.**

## Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

## Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

### Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, Group Assurance, in-house legal counsel, including the Company Secretary and General Counsel, and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;

- discussing among the engagement team and involving relevant internal specialists, including tax, pensions, IT and property specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: valuation of pub estate, onerous lease provisions and compliance with debt covenants; and
- obtaining an understanding of the legal and regulatory framework that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the Group. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pensions legislation, and tax legislation.

### Audit response to risks identified
As a result of performing the above, we identified valuation of the pub estate, onerous lease provisions and compliance with debt covenants as key audit matters. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance and reviewing Group Assurance reports; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members, including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

## Report on other legal and regulatory requirements

### Opinions on other matters prescribed by the Companies Act 2006
In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and of the Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report or the Directors' report.

### Matters on which we are required to report by exception
#### Adequacy of explanations received and accounting records
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

**We have nothing to report in respect of these matters.**

#### Directors' remuneration
Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

**We have nothing to report in respect of these matters.**

### Other matters
#### Auditor tenure
Following the recommendation of the Audit Committee, we were appointed by the Board on 10 February 2011 to audit the financial statements for the 52 weeks ending 24 September 2011 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is eight years, covering the years ending 24 September 2011 to 29 September 2018.

#### Consistency of the audit report with the additional report to the Audit Committee
Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

## Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**John Charlton FCA (Senior Statutory Auditor)**

For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

21 November 2018

# Group income statement

For the 52 weeks ended 29 September 2018

| | | 2018 52 weeks | | | 2017 53 weeks | | |
|---|---|---|---|---|---|---|---|
| | Notes | Before separately disclosed items £m | Separately disclosed items[a] £m | Total £m | Before separately disclosed items £m | Separately disclosed items[a] £m | Total £m |
| **Revenue** | 2.1, 2.3 | **2,152** | **–** | **2,152** | 2,180 | – | 2,180 |
| Operating costs before depreciation, amortisation and movements in the valuation of the property portfolio | 2.2, 2.3 | **(1,730)** | **(6)** | **(1,736)** | (1,751) | (35) | (1,786) |
| Net profit arising on property disposals | 2.2, 2.3 | **–** | **1** | **1** | – | 1 | 1 |
| **EBITDA[b]** | | **422** | **(5)** | **417** | 429 | (34) | 395 |
| Depreciation, amortisation and movements in the valuation of the property portfolio | 2.2, 2.3 | **(119)** | **(43)** | **(162)** | (115) | (72) | (187) |
| **Operating profit/(loss)** | | **303** | **(48)** | **255** | 314 | (106) | 208 |
| Finance costs | 4.3 | **(119)** | **–** | **(119)** | (125) | – | (125) |
| Finance revenue | 4.3 | **1** | **–** | **1** | 1 | – | 1 |
| Net pensions finance charge | 4.3, 4.5 | **(7)** | **–** | **(7)** | (7) | – | (7) |
| **Profit/(loss) before tax** | | **178** | **(48)** | **130** | 183 | (106) | 77 |
| Tax (charge)/credit | 2.2, 2.4 | **(33)** | **7** | **(26)** | (37) | 23 | (14) |
| **Profit/(loss) for the period** | | **145** | **(41)** | **104** | 146 | (83) | 63 |
| **Earnings per ordinary share** | | | | | | | |
| – Basic | 2.5 | **34.1p** | | **24.5p** | 34.9p | | 15.1p |
| – Diluted | 2.5 | **34.0p** | | **24.4p** | 34.8p | | 15.0p |

a. Separately disclosed items are explained and analysed in note 2.2.
b. Earnings before interest, tax, depreciation, amortisation and movements in the valuation of the property portfolio.

The notes on pages 105 to 142 form an integral part of these financial statements.

All results relate to continuing operations.

## Group statement of comprehensive income
For the 52 weeks ended 29 September 2018

| | Notes | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|---|
| **Profit for the period** | | **104** | 63 |
| **Items that will not be reclassified subsequently to profit or loss:** | | | |
| Unrealised (loss)/gain on revaluation of the property portfolio | 3.1 | **(5)** | 74 |
| Remeasurement of pension liability | 4.5 | **5** | 8 |
| Tax relating to items not reclassified | 2.4 | **–** | (13) |
| | | **–** | 69 |
| **Items that may be reclassified subsequently to profit or loss:** | | | |
| Exchange differences on translation of foreign operations | | **–** | 1 |
| Cash flow hedges: | | | |
| – Gains arising during the period | 4.4 | **16** | 60 |
| – Reclassification adjustments for items included in profit or loss | 4.4 | **34** | 53 |
| Tax relating to items that may be reclassified | 2.4 | **(8)** | (19) |
| | | **42** | 95 |
| **Other comprehensive income after tax** | | **42** | 164 |
| **Total comprehensive income for the period** | | **146** | 227 |

The notes on pages 105 to 142 form an integral part of these financial statements.

## Group balance sheet
29 September 2018

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| **Assets** | | | |
| Goodwill and other intangible assets | 3.4 | **11** | 10 |
| Property, plant and equipment | 3.1 | **4,426** | 4,429 |
| Lease premiums | | **1** | 1 |
| Interests in associates | 3.5 | **5** | – |
| Deferred tax asset | 2.4 | **63** | 110 |
| Derivative financial instruments | 4.4 | **44** | 41 |
| **Total non-current assets** | | **4,550** | 4,591 |
| Inventories | 3.2 | **26** | 24 |
| Trade and other receivables | 3.2 | **56** | 53 |
| Other cash deposits | 4.1 | **120** | 120 |
| Cash and cash equivalents | 4.1 | **122** | 147 |
| Derivative financial instruments | 4.4 | **4** | 2 |
| Assets held for sale | 3.1 | **–** | 1 |
| **Total current assets** | | **328** | 347 |
| **Total assets** | | **4,878** | 4,938 |
| **Liabilities** | | | |
| Pension liabilities | 4.5 | **(49)** | (47) |
| Trade and other payables | 3.2 | **(302)** | (297) |
| Current tax liabilities | | **(9)** | (3) |
| Borrowings | 4.2 | **(233)** | (235) |
| Derivative financial instruments | 4.4 | **(37)** | (43) |
| **Total current liabilities** | | **(630)** | (625) |
| Pension liabilities | 4.5 | **(200)** | (245) |
| Borrowings | 4.2 | **(1,744)** | (1,827) |
| Derivative financial instruments | 4.4 | **(207)** | (249) |
| Deferred tax liabilities | 2.4 | **(285)** | (324) |
| Provisions | 3.3 | **(43)** | (42) |
| **Total non-current liabilities** | | **(2,479)** | (2,687) |
| **Total liabilities** | | **(3,109)** | (3,312) |
| **Net assets** | | **1,769** | 1,626 |
| | | | |
| **Equity** | | | |
| Called up share capital | 4.7 | **37** | 36 |
| Share premium account | 4.7 | **26** | 26 |
| Capital redemption reserve | 4.7 | **3** | 3 |
| Revaluation reserve | 4.7 | **1,197** | 1,202 |
| Own shares held | 4.7 | **(1)** | (1) |
| Hedging reserve | 4.7 | **(202)** | (244) |
| Translation reserve | 4.7 | **14** | 14 |
| Retained earnings | | **695** | 590 |
| **Total equity** | | **1,769** | 1,626 |

The notes on pages 105 to 142 form an integral part of these financial statements.

The financial statements were approved by the Board and authorised for issue on 21 November 2018.

They were signed on its behalf by:

**Tim Jones Finance Director**

## Group statement of changes in equity
For the 52 weeks ended 29 September 2018

| | Called up share capital £m | Share premium account £m | Capital redemption reserve £m | Revaluation reserve £m | Own shares held £m | Hedging reserve £m | Translation reserve £m | Retained earnings £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|---|
| **At 24 September 2016** | 35 | 27 | 3 | 1,142 | (1) | (338) | 13 | 527 | 1,408 |
| Profit for the period | – | – | – | – | – | – | – | 63 | 63 |
| Other comprehensive income | – | – | – | 61 | – | 94 | 1 | 8 | 164 |
| **Total comprehensive income** | – | – | – | 61 | – | 94 | 1 | 71 | 227 |
| Credit in respect of share-based payments | – | – | – | – | – | – | – | 2 | 2 |
| Dividends paid | – | – | – | – | – | – | – | (12) | (12) |
| Revaluation reserve realised on disposal of properties | – | – | – | (1) | – | – | – | 1 | – |
| Scrip dividend related share issue | 1 | (1) | – | – | – | – | – | – | – |
| Tax on share-based payments taken directly to equity | – | – | – | – | – | – | – | 1 | 1 |
| **At 30 September 2017** | 36 | 26 | 3 | 1,202 | (1) | (244) | 14 | 590 | 1,626 |
| Profit for the period | – | – | – | – | – | – | – | 104 | 104 |
| Other comprehensive (expense)/income | – | – | – | (4) | – | 42 | | 4 | 42 |
| **Total comprehensive (expense)/ income** | – | – | – | (4) | – | 42 | – | 108 | 146 |
| Share capital issued | – | 1 | – | – | – | – | – | – | 1 |
| Credit in respect of share-based payments | – | – | – | – | – | – | – | 3 | 3 |
| Dividends paid | – | – | – | – | – | – | – | (7) | (7) |
| Revaluation reserve realised on disposal of properties | – | – | – | (1) | – | – | – | 1 | – |
| Scrip dividend related share issue | 1 | (1) | – | – | – | – | – | – | – |
| **At 29 September 2018** | **37** | **26** | **3** | **1,197** | **(1)** | **(202)** | **14** | **695** | **1,769** |

# Group cash flow statement

For the 52 weeks ended 29 September 2018

| | Notes | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|---|
| **Cash flow from operations** | | | |
| Operating profit | | **255** | 208 |
| Add back: adjusted items | 2.2 | **48** | 106 |
| Operating profit before adjusted items | | **303** | 314 |
| Add back: | | | |
| Depreciation of property, plant and equipment | 2.3 | **116** | 113 |
| Amortisation of intangibles | 2.3 | **3** | 2 |
| Cost charged in respect of share-based payments | 4.6 | **3** | 2 |
| Administrative pension costs | 4.5 | **2** | 2 |
| **Operating cash flow before adjusted items, movements in working capital and additional pension contributions** | | **427** | 433 |
| (Increase)/decrease in inventories | | **(1)** | 1 |
| Increase in trade and other receivables | | **(1)** | (20) |
| Increase in trade and other payables | | **4** | 7 |
| Decrease in provisions | | **–** | (2) |
| Additional pension contributions | 4.5 | **(48)** | (46) |
| **Cash flow from operations before adjusted items** | | **381** | 373 |
| Cash flow from adjusted items | | **(2)** | – |
| Interest paid | | **(120)** | (122) |
| Interest received | | **1** | 1 |
| Tax paid | | **(20)** | (26) |
| **Net cash from operating activities** | | **240** | 226 |
| **Investing activities** | | | |
| Purchases of property, plant and equipment | | **(167)** | (166) |
| Purchases of intangible assets | | **(4)** | (3) |
| Proceeds from sale of property, plant and equipment | | **5** | 46 |
| Acquisition of investment in associates | 3.5 | **(5)** | – |
| **Net cash used in investing activities** | | **(171)** | (123) |
| **Financing activities** | | | |
| Issue of ordinary share capital | | **1** | – |
| Dividends paid (net of scrip dividend) | 4.7 | **(7)** | (12) |
| Repayment of principal in respect of securitised debt | 4.1 | **(82)** | (77) |
| Net movement on unsecured revolving credit facilities | 4.1 | **(6)** | (25) |
| **Net cash used in financing activities** | | **(94)** | (114) |
| **Net decrease in cash and cash equivalents** | | **(25)** | (11) |
| Cash and cash equivalents at the beginning of the period | | **147** | 158 |
| **Cash and cash equivalents at the end of the period** | 4.1 | **122** | 147 |

The notes on pages 105 to 142 form an integral part of these financial statements.

## General information

Mitchells & Butlers plc (the Company) is a public limited company limited by shares and is registered in England and Wales. The Company's shares are listed on the London Stock Exchange. The address of the Company's registered office is shown on page 142.

The principal activities of the Company and its subsidiaries (the Group) and the nature of the Group's operations are set out in the Strategic report on pages 1 to 45.

Mitchells & Butlers plc, along with its subsidiaries (together 'the Group') is required to prepare its consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and in accordance with the Companies Act 2006.

The Group's accounting reference date is 30 September. The Group draws up its financial statements to the Saturday directly before or following the accounting reference date, as permitted by section 390 (3) of the Companies Act 2006. The period ended 29 September 2018 includes 52 trading weeks and the period ended 30 September 2017 includes 53 trading weeks.

The financial statements have been prepared on the historical cost basis as modified by the revaluation of properties, pension obligations and financial instruments.

The Group's accounting policies have been applied consistently.

## Basis of consolidation

The consolidated financial statements incorporate the financial statements of Mitchells & Butlers plc ('the Company') and entities controlled by the Company (its subsidiaries).

Control is achieved when the Company:

- has the power over the investee;
- is exposed, or has rights, to variable return from its involvement with the investee; and
- has the ability to use its power to affects its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of voting rights of an investee, it considers that it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- the size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Company, other vote holders or parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at the previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, the results of the subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date the Company gains control until the date when the Company ceases to control the subsidiary.

The financial statements of the subsidiaries are prepared for the same financial reporting period as the Company. Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated on consolidation.

## Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 1 to 45. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are also described within the Finance review.

In addition, note 4.4 to the financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk. As highlighted in note 4.2 to the financial statements, the Group's financing is based upon securitised debt and unsecured borrowing facilities.

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements.

## Foreign currencies

Transactions in foreign currencies are recorded at the exchange rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the relevant rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities are measured at cost using the exchange rate on the date of the initial transaction.

The consolidated financial statements are presented in pounds sterling (rounded to the nearest million), being the functional currency of the primary economic environment in which the parent and most subsidiaries operate. On consolidation, the assets and liabilities of the Group's overseas operations are translated into sterling at the relevant rates of exchange ruling at the balance sheet date. The results of overseas operations are translated into sterling at average rates of exchange for the period. Exchange differences arising from the translation of the results and the retranslation of opening net assets denominated in foreign currencies are taken directly to the Group's translation reserve. When an overseas operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

The results of overseas operations have been translated into sterling at the weighted average euro rate of exchange for the period of £1 = €1.13 (2017 £1 = €1.16), where this is a reasonable approximation to the rate at the dates of the transactions. Euro and US dollar denominated assets and liabilities have been translated at the relevant rate of exchange at the balance sheet date of £1 = €1.12 (2017 £1 = €1.13) and £1 = $1.30 (2017 £1 = $1.34) respectively.

## Recent accounting developments

The International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) have issued the following standards and interpretations which have been adopted by the Group in these financial statements for the first time:

| Accounting standard | Requirement | Impact on financial statements |
|---|---|---|
| **Amendments to IAS 7: Disclosure Initiative** | The Group has adopted the amendments to IAS 7 for the first time in the current year. The amendments require an entity to provide disclosures that enable users of the financial statements to evaluate changes in liabilities arising from financing activities, including both cash and non-cash changes. The Group's liabilities arising from financing activities consist of borrowings (note 4.2) and certain derivatives (note 4.4). Reconciliations between the opening and closing balances of these items are provided in note 4.1 and 4.4 respectively. Consistent with the transition provisions of the amendments, the Group has not disclosed comparative information for the prior year. | Apart from the additional disclosures in notes 4.1 and 4.4, the application of these amendments has had no impact on the Group's consolidated financial statements. |
| **Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses** | The Group has adopted the amendments to IAS 12 for the first time in the current year. The amendments clarify how an entity should evaluate whether there will be sufficient future taxable profits against which it can utilise a deductible temporary difference. | The application of these amendments has had no impact on the Group's consolidated financial statements as the Group already assesses the sufficiency of future taxable profits in a way that is consistent with these amendments. |
| **Annual Improvements to IFRSs: 2014 to 2016 Cycle** | The Group has adopted the amendments to IFRS 12 included in the Annual Improvements to IFRSs 2014 to 2016 Cycle for the first time in the current year. The other amendments included in this package are not yet mandatorily effective and they have not been early adopted by the Group. IFRS 12 states that an entity need not provide summarised financial information for interests in subsidiaries, associates or joint ventures that are classified (or included in a disposal group that is classified) as held for sale. | The amendments had no impact on the Group's consolidated financial statements. |

The IASB and IFRIC have issued the following standards and interpretations which could impact the Group, with an effective date for financial periods beginning on or after the dates disclosed below:

| Accounting standard | Effective date |
|---|---|
| **IFRS 15 Revenue from Contracts with Customers** | 1 January 2018 |
| **IFRS 9 Financial Instruments** | 1 January 2018 |
| **IFRS 2 (amendments) Classification and Measurement of Share-based Payment Transactions** | 1 January 2018 |
| **IAS 40 (amendments) Transfer of Investment Property** | 1 January 2018 |
| **Annual Improvements to IFRSs: 2014–2016 Cycle** | 1 January 2018 |
| **IFRIC 22 Foreign Currency Transactions and Advanced Consideration** | 1 January 2018 |
| **IFRIC 23 Uncertainty over Income Tax Treatments** | 1 January 2019 (subject to EU approval) |
| **Amendments to IAS 28 Long-term Interest in Associates and Joint Ventures** | 1 January 2019 (subject to EU approval) |
| **Annual Improvements to IFRSs 2015-2017 Cycle** | 1 January 2019 (subject to EU approval) |
| **Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement** | 1 January 2019 (subject to EU approval) |

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods. A review of the impact of IFRS 15 and IFRS 9 has been performed as described below. Beyond this, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been completed.

## Impact of adoption of IFRS 15

IFRS 15 Revenue from Contracts with Customers replaces IAS 18 Revenue and is effective for financial periods beginning on or after 1 January 2018. It applies to the Group for the 52 weeks ending 28 September 2019. IFRS 15 has been introduced to provide a single, comprehensive framework for revenue recognition. The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the standard introduces a five-step approach to revenue recognition:

Step 1: Identify the contract with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognise revenue when the entity satisfies a performance obligation

IFRS 15 is not expected to have a material impact on the Group when it is adopted, as the majority of the Group's revenue is in relation to the sale of food and drink within pubs and restaurants, for which the consideration is known and the performance obligations are satisfied at the point of sale.

## Impact of adoption of IFRS 9

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement and is effective for financial periods starting on or after 1 January 2018. It applies to the Group for the 52 weeks ending 28 September 2019. IFRS 9 has been introduced to address some of the complexity contained within IAS 39 but also introduces the concept of earlier recognition of credit losses on loans and receivables.

The adoption of IFRS 9 is not expected to have a material impact on any reported balances in the financial statements, as following assessment by management, there are no financial assets that will require a change in treatment. The Group will be required to update its hedging documentation to reflect the requirements of IFRS 9. However, there will be no change to the effectiveness of the Group's cash flow hedges. In addition, there may be minor amendments to disclosures within the financial statements.

The following standard will have a material impact on the Group when it becomes effective.

| Accounting standard | Effective date |
|---|---|
| **IFRS 16 Leases** | The standard replaces IAS 17 Leases when it becomes effective for accounting periods beginning on or after 1 January 2019. The Group currently expects to adopt IFRS 16 for the 52 week period ending 26 September 2020. |

## Impact of adoption of IFRS 16

IFRS 16 requires lessees to recognise a right-of-use asset and a corresponding liability for all leases except for low value assets or where the lease term is 12 months or less.

The right-of-use asset is initially measured at cost and subsequently measured at cost less accumulated depreciation and impairment losses. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications. As a result of this change, the income statement will include depreciation of the right-of-use asset and interest on the liability, rather than the rental expense recognised under IAS 17. Following transition, any unused onerous lease provision will transition to become a provision for impairment of right-of-use assets.

Furthermore, the classification of cash flows will also be impacted as operating lease payments under IAS 17 are presented as operating cash flows; whereas under the IFRS 16 model, the lease payments will be split into a principal and an interest portion which will be presented as financing and operating cash flows respectively.

Accounting requirements for lessors is substantially unchanged from IAS 17.

IFRS 16 will be effective for the Group for the year ending September 2020. The Group currently has operating lease commitments of £670m as disclosed in note 2.3. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16 and hence the Group will recognise a right of use asset and corresponding liabilities, unless they qualify for low value or short-term exemption. The right of use asset will be depreciated on a straight-line basis over the life of the lease. Interest will be recognised on the lease liability, resulting in a higher interest expense in the earlier years of the lease term. The total expense recognised in the Income Statement over the life of the lease will be unaffected by the new standard. There will be no impact on cash flows, although the presentation of the Group cash flow statement will change significantly, with an increase in cash flows from operating activities being offset by an increase in cash flows from financing activities.

The Group has established a working group to ensure we take all the necessary steps to comply with the requirements of IFRS 16. The working group includes our outsource partners who manage estate activity as well as key members of our finance and property teams. Work has already commenced to collate relevant data, review available system solutions and agree relevant accounting policies.

Given the number of leases and historical data requirements to adopt the fully retrospective approach, the Group intends to apply the modified retrospective approach, with assets equal to liabilities, at transition. This approach will not require restatement of comparative information.

Given the complexities of IFRS 16 and the sensitivity to key assumptions such as discount rates, it is not yet practicable to fully quantify the effect of IFRS 16 on the financial statements of the Group.

## Critical accounting judgements and estimates

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions in the application of accounting policies that affect reported amounts of assets, liabilities, income and expense.

Estimates and judgements are periodically evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Details of the Group's critical accounting judgements and estimates are described within the relevant accounting policy section in each of the notes to the financial statements.

Critical judgements are described in each section listed below:

- Note 2.2 Separately disclosed items
- Note 3.1 Property, plant and equipment
- Note 3.3 Provisions
- Note 4.5 Pensions

Critical estimates are described in:

- Note 3.1 Property, plant and equipment
- Note 3.3 Provisions

## 2.1 Segmental analysis

### Accounting policies

*Operating segments*
IFRS 8 Operating Segments requires operating segments to be based on the Group's internal reporting to its Chief Operating Decision Maker (CODM). The CODM is regarded as the Chief Executive together with other Board members. The Group trades in one business segment (that of operating pubs and restaurants) and the Group's brands meet the aggregation criteria set out in Paragraph 12 of IFRS 8. Economic indicators assessed in determining that the aggregated operating segments share similar economic characteristics include expected future financial performance; operating and competitive risks; and return on invested capital.

The disclosure set out in the Annual Report and Accounts for 2017 included segmental information for the retail operating business and property business, with an internal rent charge being levied against the Group's retail operating units by the property business. With a stable estate, the internal rent charge is no longer used by the CODM as an indicator of performance as movements in this charge are insignificant. The business is focused on delivery of sales growth and control of short-term costs within its trading pubs, in order to maximise return from its existing estate.

The CODM uses EBITDA and profit before interest and adjusted items (operating profit pre-adjustments) as the key measures of the Group's results on an aggregated basis.

*Geographical segments*
Substantially all of the Group's business is conducted in the United Kingdom. In presenting information by geographical segment, segment revenue and non-current assets are based on the geographical location of customers and assets.

### Geographical segments

| | UK | | Germany | | Total | |
|---|---|---|---|---|---|---|
| | **2018 52 weeks £m** | 2017 53 weeks £m | **2018 52 weeks £m** | 2017 53 weeks £m | **2018 52 weeks £m** | 2017 53 weeks £m |
| Revenue – sales to third parties | **2,071** | 2,100 | **81** | 80 | **2,152** | 2,180 |
| Segment non-current assets[a] | **4,428** | 4,430 | **10** | 10 | **4,438** | 4,440 |

a. Includes balances relating to intangibles, property, plant and equipment and non-current lease premiums.

## 2.2 Separately disclosed items

### Accounting policy

In addition to presenting information on an IFRS basis, the Group also presents adjusted profit and earnings per share information that excludes separately disclosed items and the impact of any associated tax. Adjusted profitability measures are presented excluding separately disclosed items as we believe this provides both management and investors with useful additional information about the Group's performance and supports a more effective comparison of the Group's trading performance from one period to the next. Adjusted profit and earnings per share information is used by management to monitor business performance against both shorter-term budgets and forecasts but also against the Group's longer-term strategic plans.

Separately disclosed items are those which are separately identified by virtue of their size or incidence and include movements in the valuation of the property portfolio as a result of the annual revaluation exercise, impairment review of short leasehold and unlicensed properties, legal costs associated with the dispute in relation to the defined benefit pension scheme and material movements in the onerous lease provision.

### Critical accounting judgements

Judgement is used to determine those items which should be separately disclosed to allow a better understanding of the adjusted trading performance of the Group. This judgement includes assessment of whether an item is of sufficient size or of a nature that is not consistent with normal trading activities.

Separately disclosed items are identified as follows:

- One-off legal costs associated with the ongoing court case between the Company and the Trustee of the Defined Benefit Pension scheme in relation to the rate of inflation applied to pension increases for certain sections of the membership. These costs would prevent year-on-year comparability of the Group's trading if not separately disclosed.
- Onerous lease provision – this provision is calculated on a site by site basis, with the majority of the additions for the prior period being disclosed separately. This prior period increase was the result of a full review of estate strategy and an update to the discount rate applied in calculating the provision. Due to the size of the resulting increase in the provision, this was disclosed separately.
- Profit/(loss) arising on property disposals – property disposals are disclosed separately as they are not considered to be part of adjusted trade performance and there is volatility in the size of the profit/(loss) in each accounting period.
- Movement in the valuation of the property portfolio – this is disclosed separately, due to the size and volatility of the movement in property valuation each period, which can be partly driven by movements in the property market. This movement is also not considered to be part of the adjusted trade performance of the Group and would prevent year-on-year comparability of the Group's trading performance if not separately disclosed.

## 2.2 Separately disclosed items continued

The items identified in the current period are as follows:

| | Notes | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|---|
| **Adjusted items** | | | |
| Legal costs associated with the defined benefit pension scheme | a | **(6)** | – |
| Onerous lease provision additions | b | **–** | (35) |
| Total adjusted items recognised within operating costs | | **(6)** | (35) |
| Net profit arising on property disposals | | **1** | 1 |
| Movement in the valuation of the property portfolio (see note 3.1): | | | |
| – Impairment arising from the revaluation | c | **(28)** | (51) |
| – Impairment of short leasehold and unlicensed properties | d | **(15)** | (17) |
| – Impairment of assets held for sale | e | **–** | (4) |
| Net movement in the valuation of the property portfolio | | **(43)** | (72) |
| **Total adjusted items before tax** | | **(48)** | (106) |
| Tax credit relating to above items | | **7** | 23 |
| **Total adjusted items after tax** | | **(41)** | (83) |

a. There are ongoing legal proceedings between the Company (as principal employer) and Mitchells & Butlers Pensions Limited (as Trustee) for which costs have been incurred both by the Company and by the Trustee but which the Company has agreed to pay. The legal proceedings are in relation to the Mitchells & Butlers Pension Plan (MABPP), whereby the Trust Deed and Rules provide that it is a matter for the Company to determine the rate of inflation which should be applied to pension increases for certain sections of the membership in excess of guaranteed minimum pensions, the Company has instructed the Trustee to apply CPI (subject to certain caps) in respect of such increases. The Trustee believes that this power was incorrectly vested in the Company in the Trust Deed and Rules of the MABPP in 1996 and, despite it being reflected in further versions of the Trust Deed and Rules, has made an application to court for those various Trust Deeds and Rules to be rectified. It is the Board's belief that the Company holds the power to fix such an inflation index and the Company is therefore contesting that application. The hearing is expected to be held in late 2019.

b. During the prior period, a review of estate strategy in relation to managed leasehold sites was completed, with specific focus on the challenges around loss-making sites and those located on retail and leisure parks. The losses were considered to be unavoidable for the remaining committed lease term. In addition, the discount rate applied in the calculation was also updated. As a result, the onerous lease provision increased significantly with the majority of this increase recognised as a separately disclosed item in the prior period. The net movement in the onerous lease provision in the current period has been included within adjusted profit as it is immaterial. See note 3.3 for further details.

c. Impairment arising from the Group's revaluation of its pub estate where the carrying values of the properties exceed their recoverable amount. See note 3.1 for further details.

d. Impairment of short leasehold and unlicensed properties where their carrying values exceed their recoverable amount. See note 3.1 for further details.

e. Impairment recognised on reclassification of property, plant and equipment to assets held for sale.

## 2.3 Revenue and operating costs

**Accounting policies**

*Revenue recognition*

Revenue is the fair value of goods sold and services rendered to third parties as part of the Group's trading activities, after deducting sales-based taxes, coupons and discounts.

Revenue – goods and services

The majority of revenue comprises food and beverages sold in the Group's businesses. This revenue is recognised at the point of sale to the customer.

Operating leases – Group as lessor

Rental income is received from unlicensed and leased operations. Income from these operating leases is recognised on a straight-line basis over the term of the lease.

*Operating profit*

Operating profit is stated after charging adjusted items but before investment income and finance costs.

Supplier incentives

Supplier incentives and rebates are recognised within operating costs as they are earned. The accrued value at the reporting date is included in other receivables.

Operating leases – Group as lessee

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases and sub-leases are charged to the income statement on a straight-line basis over the period of the lease. Lease incentives are recognised as a liability and a subsequent reduction in the rental expense over the lease term on a straight-line basis.

Premiums paid on acquiring a new lease are spread on a straight-line basis over the lease term. Such premiums are classified in the balance sheet as current or non-current lease premiums, with the current portion being the element which relates to the following period.

The Group's policy is to account for land held under both long and short leasehold contracts as operating leases, since it has no expectation that title will pass on expiry of the lease contracts.

Revenue is analysed as follows:

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Goods | **2,142** | 2,169 |
| Services | **10** | 11 |
| | **2,152** | 2,180 |

Revenue from services includes rent receivable from unlicensed properties and leased operations of £9m (2017 £10m).

Operating costs are analysed as follows:

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Raw materials and consumables recognised as an expense[a] | **564** | 573 |
| Changes in inventory of finished goods and work in progress | **(1)** | 1 |
| Employee costs | **676** | 682 |
| Hire of plant and machinery | **23** | 24 |
| Property operating lease costs | **63** | 62 |
| Other costs | **405** | 409 |
| Operating costs before depreciation, amortisation and movements in the valuation of the property portfolio | **1,730** | 1,751 |
| Other adjusted items (note 2.2) | **6** | 35 |
| | **1,736** | 1,786 |
| Net profit arising on property disposals | **(1)** | (1) |
| Depreciation of property, plant and equipment (note 3.1) | **116** | 113 |
| Amortisation of intangible assets (note 3.4) | **3** | 2 |
| Net movement in the valuation of the property portfolio (note 3.1) | **43** | 72 |
| Depreciation, amortisation and movements in the valuation of the property portfolio | **162** | 187 |
| **Total operating costs** | **1,897** | 1,972 |

a. Supplier incentives are included as a reduction to the raw materials and consumables expense. These are not disclosed separately as the value is immaterial.

## 2.3 Revenue and operating costs continued

### Employee costs

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| Wages and salaries | **620** | 625 |
| Share-based payments (note 4.6) | **3** | 2 |
| Total wages and salaries | **623** | 627 |
| Social security costs | **45** | 48 |
| Pensions (note 4.5) | **8** | 7 |
| Total employee costs | **676** | 682 |

The average number of employees including part-time employees was 43,777 retail employees (2017 44,893) and 1,025 support employees (2017 998).

Information regarding key management personnel is included in note 5.1. Detailed information regarding Directors' emoluments, pensions, long-term incentive scheme entitlements and their interests in share options is given in the Report on Directors' remuneration on pages 68 to 91.

### Operating leases

**Operating lease commitments – Group as lessee**

The vast majority of the Group's leases are industry standard UK pub or commercial property leases which provide for periodic rent reviews to open market value and enjoy statutory rights to renewal on expiry. Generally they do not contain conditions relating to rent escalation, rights to purchase, concessions, residual values or other material provisions of an unusual nature.

Total future minimum lease rental payments under non-cancellable operating leases are as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Due within one year | **55** | 54 |
| Between one and five years | **196** | 199 |
| After five years | **419** | 440 |
| | **670** | 693 |

**Operating lease receivables – Group as lessor**

The Group leases a small proportion of its unlicensed properties to tenants. The majority of lease agreements have terms of 50 years or less and are classified as operating leases. Where sublet arrangements are in place, future minimum lease payments and receipts are presented gross.

Total future minimum lease rental receipts under non-cancellable operating leases are as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Due within one year | **8** | 8 |
| Between one and five years | **26** | 27 |
| After five years | **45** | 45 |
| | **79** | 80 |

### Auditor remuneration

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| Fees payable to the Group's auditor for the: | | |
| – audit of the consolidated Group financial statements | **0.1** | 0.1 |
| – audit of the Company's subsidiaries financial statements | **0.3** | 0.3 |
| Total audit fees | **0.4** | 0.4 |
| Other fees to auditor: | | |
| – audit related assurance services | **0.1** | 0.1 |
| Total non-audit fees | **0.1** | 0.1 |

Auditor's remuneration of £0.3m (2017 £0.3m) was paid in the UK and £0.1m (2017 £0.1m) was paid in Germany.

## 2.4 Taxation

### Accounting policies

*Current tax*

The income tax expense represents both the income tax payable, based on profits for the period, and deferred tax and is calculated using tax rates enacted or substantively enacted at the balance sheet date. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense which are not taxable. Income tax is recognised in the income statement except when it relates to items that are charged or credited in other comprehensive income or directly in equity, in which case the income tax is also charged or credited in other comprehensive income or directly in equity.

*Deferred tax*

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profits and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associate with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised based on tax laws and rates that have been substantively enacted at the balance sheet date. The amount of deferred tax recognised is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities.

### Taxation – income statement

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Current tax: | | |
| – UK corporation tax | **(28)** | (20) |
| – Amounts over provided in prior periods | **2** | 3 |
| Total current tax charge | **(26)** | (17) |
| Deferred tax: | | |
| – Origination and reversal of temporary differences | **–** | 7 |
| – Adjustments in respect of prior periods | **–** | (4) |
| Total deferred tax credit | **–** | 3 |
| Total tax charged in the income statement | **(26)** | (14) |
| Further analysed as tax relating to: | | |
| Profit before adjusted items | **(33)** | (37) |
| Adjusted items | **7** | 23 |
| | **(26)** | (14) |

The standard rate of corporation tax applied to the reported profit is 19.0% (2017 19.5%). The applicable rate has changed following the substantive enactment of the Finance (No.2) Act 2015 on 18 November 2015, which reduced the main rate of corporation tax from 20% to 19% from 1 April 2017.

The tax charge in the income statement for the period is higher (2017 lower) than the standard rate of corporation tax in the UK. The differences are reconciled below:

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Profit before tax | **130** | 77 |
| Taxation charge at the UK standard rate of corporation tax of 19.0% (2017 19.5%) | **(25)** | (15) |
| Expenses not deductible | **(4)** | (4) |
| Income not taxable | **2** | 9 |
| Adjustments in respect of prior periods | **2** | (1) |
| Effect of different tax rates of subsidiaries operating in other jurisdictions | **(1)** | (1) |
| Effect of different rates for deferred tax and corporation tax | **–** | (2) |
| Total tax charge in the income statement | **(26)** | (14) |

Taxation for other jurisdictions is calculated at the rates prevailing in those jurisdictions.

## 2.4 Taxation continued

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| **Deferred tax in the income statement:** | | |
| Accelerated capital allowances | **1** | 5 |
| Retirement benefit obligations | **(6)** | (6) |
| Rolled over and held over gains | **–** | 4 |
| Depreciated non-qualifying assets | **1** | 1 |
| Unrealised gains on revaluations | **5** | 7 |
| Tax losses – UK | **(2)** | (6) |
| Tax losses – overseas | **1** | (2) |
| Total deferred tax credit in the income statement | **–** | 3 |

### Taxation – other comprehensive income

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| Deferred tax: | | |
| Items that will not be reclassified subsequently to profit or loss: | | |
| – Unrealised losses/(gains) due to revaluations – revaluation reserve | **1** | (13) |
| – Unrealised gains due to revaluations – retained earnings | **–** | 1 |
| – Remeasurement of pension liability | **(1)** | (1) |
| | **–** | (13) |
| Items that may be reclassified subsequently to profit or loss: | | |
| – Cash flow hedges: | | |
| – Gains arising during the period | **(3)** | (10) |
| – Reclassification adjustments for items included in profit or loss | **(5)** | (9) |
| | **(8)** | (19) |
| Total tax charge recognised in other comprehensive income | **(8)** | (32) |

### Tax relating to items recognised directly in equity

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| Deferred tax: | | |
| – Tax credit related to share-based payments | **–** | 1 |

### Taxation – balance sheet

The deferred tax assets and liabilities recognised in the balance sheet are shown below:

| | 2018 £m | 2017 £m |
|---|---|---|
| **Deferred tax asset:** | | |
| Retirement benefit obligations (note 4.5) | **43** | 50 |
| Derivative financial instruments | **42** | 50 |
| Tax losses – UK | **6** | 8 |
| Tax losses – overseas | **1** | – |
| Share-based payments | **2** | 2 |
| Total deferred tax asset | **94** | 110 |
| **Deferred tax liability:** | | |
| Accelerated capital allowances | **(31)** | (32) |
| Rolled over and held over gains | **(112)** | (112) |
| Unrealised gains on revaluations | **(170)** | (176) |
| Depreciated non-qualifying assets | **(3)** | (4) |
| Total deferred tax liability | **(316)** | (324) |
| Total | **(222)** | (214) |

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset income tax assets and income tax liabilities and when it is the intention to settle the balances on a net basis. Deferred tax assets and liabilities have been offset and disclosed in the balance sheet as follows:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Deferred tax asset | **63** | 110 |
| Deferred tax liability | **(285)** | (324) |
| Net deferred tax liability | **(222)** | (214) |

### Unrecognised tax allowances

At the balance sheet date the Group had unused tax allowances of £87m in respect of unclaimed capital allowances (2017 £80m) available for offset against future profits.

A deferred tax asset has not been recognised on tax allowances with a value of £15m (2017 £14m) because it is not certain that future taxable profits will be available in the company where these tax allowances arose against which the Group can utilise these benefits. These tax credits can be carried forward indefinitely.

### Factors which may affect future tax charges

The Finance Act 2016 was substantively enacted on 15 September 2016 and reduced the main rate of corporation tax from 19% to 17% from 1 April 2020. The effect of these changes has been reflected in the closing deferred tax balances at 30 September 2017 and 29 September 2018.

## 2.5 Earnings per share

Basic earnings per share (EPS) has been calculated by dividing the profit or loss for the period by the weighted average number of ordinary shares in issue during the period, excluding own shares held by employee share trusts.

For diluted earnings per share, the weighted average number of ordinary shares is adjusted to assume conversion of all dilutive potential ordinary shares.

Adjusted earnings per ordinary share amounts are presented before adjusted items (see note 2.2) in order to allow a better understanding of the adjusted trading performance of the Group.

| | **Profit £m** | **Basic EPS pence per ordinary share** | **Diluted EPS pence per ordinary share** |
|---|---|---|---|
| **52 weeks ended 29 September 2018:** | | | |
| Profit/EPS | **104** | **24.5p** | **24.4p** |
| Adjusted items, net of tax | **41** | **9.6p** | **9.6p** |
| Adjusted profit/EPS[a] | **145** | **34.1p** | **34.0p** |
| **53 weeks ended 30 September 2017:** | | | |
| Profit/EPS | 63 | 15.1p | 15.0p |
| Adjusted items, net of tax | 83 | 19.8p | 19.8p |
| Adjusted profit/EPS[a] | 146 | 34.9p | 34.8p |

a. Adjusted profit and adjusted EPS are alternative performance measures (APMs) and are considered critical to aid understanding of the Group's performance. These measures are explained on pages 148 to 150 of this report.

The weighted average number of ordinary shares used in the calculations above are as follows:

| | **2018 52 weeks m** | 2017 53 weeks m |
|---|---|---|
| For basic EPS calculations | **425** | 418 |
| Effect of dilutive potential ordinary shares: | | |
| – Contingently issuable shares | **2** | 1 |
| For diluted EPS calculations | **427** | 419 |

At 29 September 2018, 2,746,844 (2017 3,124,559) other share options were outstanding that could potentially dilute basic EPS in the future but were not included in the calculation of diluted EPS as they are anti-dilutive for the periods presented.

## 3.1 Property, plant and equipment

### Accounting policies

*Property, plant and equipment*

The majority of the Group's freehold and long leasehold licensed land and buildings are revalued annually and are therefore held at fair value less depreciation.

Short leasehold buildings (leases with an unexpired lease term of less than 50 years), unlicensed land and buildings and fixtures, fittings and equipment are held at cost less depreciation and impairment.

All land and buildings are disclosed as a single class of asset within the property, plant and equipment table, as we do not consider the short leasehold and unlicensed buildings to be material for separate disclosure.

Non-current assets held for sale are held at their carrying value or their fair value less costs to sell where this is lower.

*Depreciation*

Depreciation is charged to the income statement on a straight-line basis to write off the cost less residual value over the estimated useful life of an asset and commences when an asset is ready for its intended use. Expected useful lives and residual values are reviewed each year and adjusted if appropriate.

Freehold land is not depreciated.

Freehold and long leasehold buildings are depreciated so that the difference between their carrying value and estimated residual value is written off over 50 years from the date of acquisition. The residual value of freehold and long leasehold buildings is reassessed each year and is estimated to be equal to the fair value determined in the annual valuation and therefore no depreciation charge is recognised.

Short leasehold buildings, and associated fixtures, fittings and equipment, are depreciated over the shorter of the estimated useful life and the unexpired term of the lease.

Fixtures, fittings and equipment have the following estimated useful lives:

| | |
|---|---|
| Information technology equipment | 3 to 7 years |
| Fixtures and fittings | 3 to 20 years |

At the point of transfer to non-current assets held for sale, depreciation ceases. Should an asset be subsequently reclassified to property, plant and equipment, the depreciation charge is calculated to reflect the cumulative charge had the asset not been reclassified.

*Disposals*

Profits and losses on disposal of property, plant and equipment are calculated as the difference between the net sales proceeds and the carrying amount of the asset at the date of disposal.

*Revaluation*

The revaluation utilises valuation multiples, which are determined via third-party inspection of 20% of the sites such that all sites are individually valued approximately every five years; estimates of fair maintainable trade (FMT); and estimated resale value of tenant's fixtures and fittings. Properties are valued as fully operational entities, to include fixtures and fittings but excluding stock and personal goodwill. The value of tenant's fixtures and fittings is then removed from this valuation via reference to its associated resale value. Where sites have been impacted by expansionary capital investment in the preceding twelve months, FMT is taken as the lower of the post investment forecast or the prior year FMT, as the current year trading performance includes a period of closure.

Valuation multiples derived via third-party inspections determine brand standard multiples which are then used to value the remainder of the non-inspected estate via an extrapolation exercise, with the output of this exercise reviewed at a high level by the Directors and the third-party valuer.

Where the value of land and buildings derived purely from a multiple applied to the fair maintainable trade misrepresents the underlying asset value, for example, due to low levels of income or location characteristics, a spot valuation is applied.

Surpluses which arise from the revaluation exercise are included within other comprehensive income (in the revaluation reserve) unless they are reversing a revaluation adjustment which has been recognised in the income statement previously; in which case an amount equal to a maximum of that recognised in the income statement previously is recognised in income. Where the revaluation exercise gives rise to a deficit, this is reflected directly within the income statement, unless it is reversing a previous revaluation surplus against the same asset; in which case an amount equal to the maximum of the revaluation surplus is recognised within other comprehensive income (in the revaluation reserve).

*Impairment*

Short leasehold and unlicensed properties are reviewed on an outlet basis for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised whenever the carrying amount of an outlet exceeds its recoverable amount. The recoverable amount is the higher of an outlet's fair value less costs to sell and value in use. Any changes in outlet earnings, or cash flows, the discount rate applied to those cash flows, or the estimate of sales proceeds could give rise to an additional impairment loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised as income immediately. An impairment reversal is only recognised where there is a change in the estimates used to determine recoverable amounts, not where it results from the passage of time.

**Critical accounting judgements**

The revaluation methodology is determined using management judgement, with advice from third-party valuers. The application of a valuation multiple to the fair maintainable trade of each site is considered the most appropriate method for the Group to determine the fair value of licensed land and buildings. Where sites have been impacted by expansionary capital investment in the preceding twelve months, management judgement is used to determine the most appropriate FMT. The FMT is taken as the lower of the post investment forecast or the prior year FMT, as the current year trading performance includes a period of closure.

**Critical accounting estimates**

The application of the valuation methodology requires two critical accounting estimates; the estimation of valuation multiples, which are determined via third-party inspections; and an estimate of fair maintainable trade, including reference to historic and future projected income levels. A sensitivity analysis of changes in valuation multiples and FMT, in relation to the properties to which these estimates apply, is provided on page 118. The carrying value of properties to which these estimates apply is £4,230m (2017 £4,230m).

When a review for impairment is conducted for short leasehold properties, the recoverable amount is determined based on value in use calculations. The value in use calculation requires two critical accounting estimates; the estimation of future cash flows, including reference to historical and future projected income levels; and the selection of an appropriate risk-adjusted discount rate. A sensitivity analysis of changes in future cash flows and discount rate, in relation to the properties to which these estimates apply, is provided on page 118. The carrying value of properties to which these estimates apply is £156m (2017 £170m).

### Property, plant and equipment

Property, plant and equipment can be analysed as follows:

| | Land and buildings £m | Fixtures, fittings and equipment £m | Total £m |
|---|---|---|---|
| **Cost or valuation** | | | |
| At 24 September 2016 | 3,934 | 1,107 | 5,041 |
| Additions | 43 | 120 | 163 |
| Disposals[a] | (7) | (73) | (80) |
| Transfers to assets held for sale | (30) | (25) | (55) |
| Revaluation/(impairment) | 13 | (11) | 2 |
| At 30 September 2017 | 3,953 | 1,118 | 5,071 |
| Additions | 39 | 125 | 164 |
| Disposals[a] | (12) | (123) | (135) |
| Revaluation/(impairment) | (41) | (7) | (48) |
| **At 29 September 2018** | **3,939** | **1,113** | **5,052** |
| **Accumulated depreciation** | | | |
| At 24 September 2016 | 77 | 541 | 618 |
| Provided during the period | 6 | 107 | 113 |
| Disposals[a] | (5) | (72) | (77) |
| Transfers to assets held for sale | – | (12) | (12) |
| At 30 September 2017 | 78 | 564 | 642 |
| Provided during the period | 6 | 110 | 116 |
| Disposals[a] | (10) | (122) | (132) |
| **At 29 September 2018** | **74** | **552** | **626** |
| **Net book value** | | | |
| **At 29 September 2018** | **3,865** | **561** | **4,426** |
| At 30 September 2017 | 3,875 | 554 | 4,429 |
| At 24 September 2016 | 3,857 | 566 | 4,423 |

a. Includes assets which are fully depreciated and have been removed from the fixed asset register.

Certain assets with a net book value of £43m (2017 £44m) owned by the Group are subject to a fixed charge in respect of liabilities held by the Mitchells & Butlers Executive Top-Up Scheme (MABETUS).

Included within property, plant and equipment are assets with a net book value of £3,788m (2017 £3,808m), which are pledged as security for the securitisation debt and over which there are certain restrictions on title.

Cost at 29 September 2018 includes £18m (2017 £10m) of assets in the course of construction.

## 3.1 Property, plant and equipment continued

### Revaluation of freehold and long leasehold properties

The freehold and long leasehold properties have been valued at fair value, as at 29 September 2018 using information provided by CBRE, independent chartered surveyors. The valuation was carried out in accordance with the RICS Valuation – Global Standards 2017 which incorporate the International Valuation Standards and the RICS Valuation – Professional Standards UK January 2014 (revised April 2015) (the 'Red Book') assuming each asset is sold as a fully operational trading entity. The fair value has been determined having regard to factors such as current and future projected income levels, taking account of location, quality of the pub restaurant and recent market transactions in the sector.

#### Sensitivity analysis

Changes in either the FMT or the multiple could materially impact the valuation of the freehold and long leasehold properties. The average movement in FMT of revalued properties in recent years is 1.0%. It is estimated that, given the multiplier effect, a 1.0% change in the FMT of the freehold or long leasehold properties would generate an approximate £37m movement in their valuation.

Multiples are determined at an individual brand level. The average movement in weighted average of all brand multiples in recent years is 0.1. It is estimated that a 0.1 change in the multiple would generate an approximate £42m movement in valuation.

### Impairment review of short leasehold and unlicensed properties

Short leasehold and unlicensed properties (comprising land and buildings and fixtures, fittings and equipment) which are not revalued to fair market value, are reviewed for impairment by comparing site value in use calculations to their carrying values. The value in use calculation uses forecast trading performance cash flows, which are discounted by applying a pre-tax discount rate of 7.5% (2017 7.0%). Any resulting impairment relates to sites with poor trading performance, where the output of the value in use calculation is insufficient to justify their current net book value.

#### Sensitivity analysis

The Group has performed a sensitivity analysis on the impairment tests for its short leasehold properties using various reasonably possible scenarios. It is estimated that a 5.0% decline in the EBITDA of the short leasehold properties would generate an approximate £1m increase in the impairment charge.

It is also estimated that 0.5% increase in the discount rate would not result in a significant increase to the impairment charge. The movement of 0.5% is considered reasonable, given that the discount rate has increased by 0.5% in the current period.

Current year valuations have been incorporated into the financial statements and the resulting revaluation adjustments have been taken to the revaluation reserve or income statement as appropriate. The impact of the revaluations/impairments described above is as follows:

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| **Income statement** | | |
| Revaluation loss charged as an impairment | **(89)** | (109) |
| Reversal of past impairments | **61** | 58 |
| Total impairment arising from the revaluation | **(28)** | (51) |
| Impairment of short leasehold and unlicensed properties | **(15)** | (17) |
| Impairment of assets held for sale | **–** | (4) |
| | **(43)** | (72) |
| **Revaluation reserve** | | |
| Unrealised revaluation surplus | **171** | 210 |
| Reversal of past revaluation surplus | **(176)** | (136) |
| | **(5)** | 74 |
| **Net (decrease)/increase in property, plant and equipment** | **(48)** | 2 |

The valuation techniques are consistent with the principles in IFRS 13 and use significant unobservable inputs such that the fair value measurement of each property within the portfolio has been classified as Level 3 in the fair value hierarchy.

The key inputs to valuation on property, plant and equipment are as follows:

| **29 September 2018** | **Number of pubs** | **Land and buildings £m** | **Fixtures, fittings and equipment £m** | **Net book value[a] £m** |
|---|---|---|---|---|
| Freehold properties | **1,336** | **3,507** | **428** | **3,935** |
| Long leasehold properties | **95** | **259** | **36** | **295** |
| Total revalued properties | **1,431** | **3,766** | **464** | **4,230** |
| Short leasehold properties | | **77** | **79** | **156** |
| Unlicensed properties | | **14** | **2** | **16** |
| Other non-pub assets | | **3** | **3** | **6** |
| Assets under construction | | **5** | **13** | **18** |
| Total property, plant and equipment | | **3,865** | **561** | **4,426** |

| 30 September 2017 | Number of pubs | Land and buildings £m | Fixtures, fittings and equipment £m | Net book value[a] £m |
|---|---|---|---|---|
| Freehold properties | 1,339 | 3,512 | 426 | 3,938 |
| Long leasehold properties | 95 | 256 | 36 | 292 |
| Total revalued properties | 1,434 | 3,768 | 462 | 4,230 |
| Short leasehold properties | | 86 | 84 | 170 |
| Unlicensed properties | | 14 | 2 | 16 |
| Other non-pub assets | | 1 | 2 | 3 |
| Assets under construction | | 6 | 4 | 10 |
| Total property, plant and equipment | | 3,875 | 554 | 4,429 |

a. The carrying value of freehold and long leasehold properties based on their historical cost (or deemed cost at transition to IFRS) is £2,635m and £186m respectively (2017 £2,625m and £188m).

The tables below show, by class of asset, the number of properties that have been valued within each FMT and multiple banding:

| | **Valuation multiple applied to FMT** | | | | | |
|---|---|---|---|---|---|---|
| **29 September 2018** | **Over 12 times** | **10 to 12 times** | **8 to 10 times** | **6 to 8 times** | **Under 6 times** | **Total** |
| Number of pubs in each FMT income banding: | | | | | | |
| < £200k pa | **48** | **6** | **166** | **170** | **10** | **400** |
| £200k to £360k pa | **–** | **12** | **311** | **138** | **15** | **476** |
| > £360k pa | **3** | **54** | **414** | **65** | **19** | **555** |
| | **51** | **72** | **891** | **373** | **44** | **1,431** |

| | Valuation multiple applied to FMT | | | | | |
|---|---|---|---|---|---|---|
| 30 September 2017 | Over 12 times | 10 to 12 times | 8 to 10 times | 6 to 8 times | Under 6 times | Total |
| Number of pubs in each FMT income banding: | | | | | | |
| < £200k pa | 46 | 11 | 153 | 190 | 12 | 412 |
| £200k to £360k pa | – | 11 | 315 | 141 | 13 | 480 |
| > £360k pa | 2 | 52 | 406 | 59 | 23 | 542 |
| | 48 | 74 | 874 | 390 | 48 | 1,434 |

Year-on-year movements in valuation multiples are the result of changes in property market conditions. The average weighted multiple is 8.6 (2017 8.5).

In addition to the above, premiums paid on acquiring a new lease are classified separately in the balance sheet. At 29 September 2018 an amount of £1m (2017 £1m) was included in the balance sheet.

## Assets held for sale

| | **2018 £m** | 2017 £m |
|---|---|---|
| Properties | **–** | 1 |

In accordance with IFRS 5, properties categorised as held for sale are held at the lower of book value and fair value less costs to sell.

During 2017, £43m of properties were classified as held for sale. An impairment of £4m was recognised prior to reclassification. Subsequently, £42m of properties were sold, leaving £1m remaining as held for sale at the balance sheet date.

During 2018, the remaining £1m of properties were sold.

## Capital commitments

| | **2018 £m** | 2017 £m |
|---|---|---|
| Contracts placed for expenditure on property, plant and equipment not provided for in the financial statements | **24** | 23 |

## 3.2 Working capital

### Inventories

**Accounting policy**
Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Inventories can be analysed as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Goods held for resale | **26** | 24 |

### Trade and other receivables

**Accounting policy**
Trade and other receivables are recognised and carried at original cost less an allowance for any uncollectable amounts.

Trade and other receivables can be analysed as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Trade receivables | **7** | 5 |
| Other receivables | **14** | 15 |
| Prepayments | **35** | 33 |
| Total trade and other receivables | **56** | 53 |

All amounts fall due within one year.

Trade and other receivables are non-interest bearing and are classified as loans and receivables and are therefore held at amortised cost. Trade and other receivables past due and not impaired are immaterial and therefore no further analysis is presented. The Directors consider that the carrying amount of trade and other receivables approximately equates to their fair value.

Credit risk is considered in note 4.4.

### Trade and other payables

**Accounting policy**
Trade and other payables are recognised at amortised cost.

Trade and other payables can be analysed as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Trade payables | **83** | 80 |
| Other taxation and social security | **64** | 70 |
| Accrued charges | **103** | 102 |
| Other payables | **52** | 45 |
| Total trade and other payables | **302** | 297 |

Current trade and other payables are non-interest bearing. The Directors consider that the carrying amount of trade and other payables approximately equates to their fair value.

## 3.3 Provisions

### Accounting policy

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured using the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date and are discounted to present value where the effect is material.

Onerous property provisions represent the expected unavoidable losses on onerous and vacant property leases and comprise the lower of the net rent payable or the operating loss after rental costs. The provision is calculated on a site by site basis with a provision being made for the remaining committed lease term, where a lease is considered to be onerous. Other contractual dilapidations costs are also recorded as provisions as appropriate.

### Critical accounting judgements

Determination of whether a loss is unavoidable requires areas of judgement such as consideration of potential future investment decisions, local conditions which may be impacting on current performance.

### Critical accounting estimates

In relation to onerous property provisions, estimates are required in determining the future EBITDA performance of each site and the potential to exit leases earlier than the expiry date. A sensitivity analysis of changes in these estimates is provided below. The value of provisions to which these estimates apply is £43m (2017 £42m).

### Provisions

The provision for unavoidable losses on onerous property leases has been set up to cover rental payments of vacant or loss-making properties. Payments are expected to continue on these properties for periods of 1 to 25 years.

Provisions can be analysed as follows:

| | Property leases £m |
|---|---|
| At 24 September 2016 | 9 |
| Released in the period[a] | (1) |
| Provided in the period[b] | 36 |
| Unwinding of discount | 1 |
| Utilised in the period | (3) |
| At 30 September 2017 | 42 |
| Released in the period[a] | (6) |
| Provided in the period[b] | 11 |
| Unwinding of discount | 1 |
| Utilised in the period | (5) |
| **At 29 September 2018** | **43** |

a. Releases in the prior period primarily related to property disposals. Releases in the current period primarily relate to improvement in performance of managed properties.
b. During the prior period, a full review of estate strategy in relation to managed leasehold properties was completed, with specific focus on the challenges around loss-making sites and those located on retail and leisure parks. With lower footfall on many of these parks and the continued uncertain economic outlook, alongside increased cost pressures such as living wage, business rates review, apprenticeship levy, sugar tax and food price inflation, a number of short leasehold sites were considered to be challenged when striving to achieve a break-even profit performance. As a result, the losses were considered unavoidable for the remaining committed lease term for managed properties. In addition, the discount rate applied in the calculation was updated. As a result of these changes, a £35m increase in the provision was included as a separately disclosed item (see note 2.2). The remaining increase of £1m was recognised within adjusted profit, as this represented unavoidable losses on unlicensed properties.

### Sensitivity analysis

The Group has performed a sensitivity analysis on the onerous lease provision calculation using various reasonably possible scenarios. It is estimated that a 5% decline in the future EBITDA performance of the sites included in the provision would generate an additional provision of £1m. It is also estimated that, should all leases with more than 10 years remaining on the committed lease term be exited two years ahead of expiry, the provision would reduce by £1m.

## 3.4 Goodwill and other intangible assets

### Accounting policies

*Business combinations and goodwill*
Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured at the aggregate of the fair values of assets given and liabilities incurred or assumed by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in the income statement as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with IAS 12 Income Taxes and IAS 19 Employee Benefits (revised) respectively; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations are measured in accordance with that standard.

Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree over the net of the identifiable assets acquired and the liabilities assumed at the acquisition date. If, after reassessment, the net of the identifiable assets acquired and liabilities assumed at the acquisition date exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree, the excess is recognised immediately in the income statement as a bargain purchase.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition date fair value and included as part of the contingent consideration transferred in a business combination. Changes in fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not re-measured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is re-measured at subsequent reporting dates, at fair value, with the corresponding gain or loss being recognised in the income statement.

When a business combination is achieved in stages, the Group's previously-held interests in the acquired entity is re-measured to its acquisition date fair value and the resulting gain or loss, if any, is recognised in the income statement. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

Goodwill is not amortised, but is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. The impairment review requires management to consider the recoverable value of the business to which the goodwill relates, based on either the fair value less costs to sell or the value in use. Value in use calculations require management to consider the net present value of future cash flows generated by the business to which the goodwill relates. Fair value less costs to sell is based on management's estimate of the net proceeds which could be generated through disposing of that business. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

*Computer software*
Computer software and associated development costs, which are not an integral part of a related item of hardware, are capitalised as an intangible asset and amortised on a straight-line basis over their useful life. The period of amortisation ranges between three and seven years with the majority being five years.

### Intangible assets

Intangible assets can be analysed as follows:

| | Goodwill £m | Computer software £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 24 September 2016 | 7 | 11 | 18 |
| Additions | – | 3 | 3 |
| At 30 September 2017 | 7 | 14 | 21 |
| Additions | – | 4 | 4 |
| Disposals | – | (2) | (2) |
| **At 29 September 2018** | **7** | **16** | **23** |
| | | | |
| **Accumulated amortisation and impairment** | | | |
| At 24 September 2016 | 5 | 4 | 9 |
| Provided during the period | – | 2 | 2 |
| At 30 September 2017 | 5 | 6 | 11 |
| Provided during the period | – | 3 | 3 |
| Disposals | – | (2) | (2) |
| **At 29 September 2018** | **5** | **7** | **12** |
| | | | |
| **Net book value** | | | |
| **At 29 September 2018** | **2** | **9** | **11** |
| At 30 September 2017 | 2 | 8 | 10 |
| At 24 September 2016 | 2 | 7 | 9 |

There are no intangible assets with indefinite useful lives. All amortisation charges have been expensed through operating costs.

Goodwill has been tested for impairment on a site-by-site basis using forecast cash flows, discounted by applying a pre-tax discount rate of 7.5% (2017 7.0%). For the purposes of the calculation of the recoverable amount, the cash flow projections beyond the two year period include 0.0% (2017 2.0%) growth per annum.

## 3.5 Associates

**Accounting policies**

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results, assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

Under the equity method, an investment in an associate is accounted for using the equity method from the date on which the investee becomes an associate. On acquisition of the investment in an associate, any excess of the cost of the investment over the Group's share of the net fair value of the identifiable assets and liabilities of the investee is recognised as goodwill, which is included within the carrying amount of the investment. If after reassessment the Group's share of the net fair value of the identifiable assets and liabilities are in excess of the cost of the investment, this is recognised immediately in profit or loss in the period in which the investment is acquired.

The requirements of IAS 36 Impairment of Assets are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs of disposal) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

The Group discontinues the use of the equity method from the date when the investment ceases to be an associate, or when the investment is classified as held for sale. When the Group retains an interest in the former associate and the retained interest is a financial asset, the Group measures the retained interest at fair value at that date and the fair value is regarded as its fair value on initial recognition in accordance with IAS 39. The difference between the carrying amount of the associate at the date the equity method was discontinued, and the fair value of any retained interest and any proceeds from disposing of a part interest in the associate is included in the determination of the gain or loss on disposal of the associate. In addition, the Group accounts for all amounts previously recognised in other comprehensive income in relation to that associate on the same basis as would be required if that associate had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income by that associate would be reclassified to profit or loss on the disposal of the related assets or liabilities, the Group reclassifies the gain or loss from equity to profit or loss when the equity method is discontinued.

When the Group reduces its ownership interest in an associate but the Group continues to use the equity method, the Group reclassifies to profit or loss the proportion of the gain or loss that had previously been recognised in other comprehensive income relating to that reduction in ownership interest if that gain or loss would be reclassified to profit or loss on the disposal of the related assets or liabilities.

When a Group entity transacts with an associate of the Group, profits and losses resulting from the transactions with the associate are recognised in the Group's consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

The nature of the activities of all of the Group's associates is trading in pubs and restaurants, which are seen as complementing the Group's operations and contributing to the Group's overall strategy.

Associates can be analysed as follows:

| | £m |
|---|---|
| At 24 September 2016 and 30 September 2017 | – |
| Acquisitions* | 5 |
| **At 29 September 2018** | **5** |

* Acquisitions in the period relate to the shares purchased in 3Sixty Restaurants Limited and Fatboy Pub Company Limited. Details of these associates are provided in note 5.2.

During the period, a put and call option agreement was entered into, which allows the Company to acquire the remaining 60% share capital of the associate, 3Sixty Restaurants Limited, at any point in time after three years from the initial purchase date. The initial 40% investment was purchased on 1 August 2018 for £4m. The current shareholders also have the option to sell the remaining 60% to the Company, subject to a number of conditions.

## 4.1 Net debt

**Accounting policy**
*Cash and cash equivalents*
Cash and cash equivalents comprise cash at bank and in hand and other short-term highly liquid deposits with an original maturity at acquisition of three months or less. Cash held on deposit with an original maturity at acquisition of more than three months is disclosed as other cash deposits. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand.

### Net debt

| | 2018 £m | 2017 £m |
|---|---|---|
| Cash and bank balances | **122** | 147 |
| Cash and cash equivalents | **122** | 147 |
| Other cash deposits | **120** | 120 |
| Securitised debt (note 4.2) | **(1,830)** | (1,909) |
| Liquidity facility (note 4.2) | **(147)** | (147) |
| Revolving credit facilities (note 4.2) | **–** | (6) |
| Derivatives hedging securitised debt[a] (note 4.2) | **47** | 45 |
| | **(1,688)** | (1,750) |

a. Represents the element of the fair value of currency swaps hedging the balance sheet value of the Group's US$ denominated A3N loan notes. This amount is disclosed separately to remove the impact of exchange movements which are included in the securitised debt amount.

### Movement in net debt

| | 2018 52 weeks £m | 2017 53 weeks £m |
|---|---|---|
| **Net decrease in cash and cash equivalents** | **(25)** | (11) |
| Add back cash flows in respect of other components of net debt: | | |
| Repayment of principal in respect of securitised debt | **82** | 77 |
| Net movement on unsecured revolving facilities | **6** | 25 |
| **Decrease in net debt arising from cash flows** | **63** | 91 |
| Movement in capitalised debt issue costs net of accrued interest | **(1)** | (1) |
| **Decrease in net debt** | **62** | 90 |
| Opening net debt | **(1,750)** | (1,840) |
| **Closing net debt** | **(1,688)** | (1,750) |

The net debt movement for the 52 weeks ended 29 September 2018 is represented by:

| | At 30 September 2017 £m | Cash flow movements in the period £m | Non-cash movements in the period £m | Fair value movements £m | At 29 September 2018 £m |
|---|---|---|---|---|---|
| Cash and cash equivalents | 147 | (25) | – | – | **122** |
| Other cash deposits | 120 | – | – | – | **120** |
| Securitised debt* | (1,909) | 82 | (3) | – | **(1,830)** |
| Liquidity facility* | (147) | – | – | – | **(147)** |
| Revolving credit facilities* | (6) | 6 | – | – | **–** |
| Derivatives hedging securitised debt* | 45 | – | – | 2 | **47** |
| **Net debt** | (1,750) | 63 | (3) | 2 | **(1,688)** |

* Liabilities arising from financing activities.

The net debt movement for the 53 weeks ended 30 September 2017 is represented by:

| | At 24 September 2016 £m | Cash flow movements in the period £m | Non-cash movements in the period £m | Fair value movements £m | At 30 September 2017 £m |
|---|---|---|---|---|---|
| Cash and cash equivalents | 158 | (11) | – | – | 147 |
| Other cash deposits | 120 | – | – | – | 120 |
| Securitised debt* | (1,995) | 77 | 9 | – | (1,909) |
| Liquidity facility* | (147) | – | – | – | (147) |
| Revolving credit facilities* | (31) | 25 | – | – | (6) |
| Derivatives hedging securitised debt* | 55 | – | – | (10) | 45 |
| **Net debt** | (1,840) | 91 | 9 | (10) | (1,750) |

* Liabilities arising from financing activities.

## 4.2 Borrowings

### Accounting policy

Borrowings, which include the Group's secured loan notes, are stated initially at fair value (normally the amount of the proceeds) net of issue costs. Thereafter they are stated at amortised cost using an effective interest basis. Finance costs, which are the difference between the net proceeds and the total amount of payments to be made in respect of the instruments, are allocated over the term of the debt using the effective interest method. Borrowing costs are not attributed to the acquisition or construction of assets and therefore no costs are capitalised within property, plant and equipment.

Borrowings can be analysed as follows:

| | **2018 £m** | 2017 £m |
|---|---|---|
| **Current** | | |
| Securitised debt[a,b] | **86** | 82 |
| Liquidity facility | **147** | 147 |
| Unsecured revolving credit facilities | **–** | 6 |
| Total current | **233** | 235 |
| **Non-current** | | |
| Securitised debt[a,b] | **1,744** | 1,827 |
| Total borrowings | **1,977** | 2,062 |

a. Further details of the assets pledged as security against the securitised debt are given on page 117.
b. Stated net of deferred issue costs.

| | **2018 £m** | 2017 £m |
|---|---|---|
| **Analysis by year of repayment** | | |
| Due within one year or on demand | **233** | 235 |
| Due between one and two years | **142** | 130 |
| Due between two and five years | **328** | 307 |
| Due after five years | **1,274** | 1,390 |
| Total borrowings | **1,977** | 2,062 |

### Securitised debt

On 13 November 2003, the Group refinanced its debt by raising £1,900m through a securitisation of the majority of its UK pubs and restaurants owned by Mitchells & Butlers Retail Limited ('MAB Retail'). On 15 September 2006 the Group completed a further debt ('tap') issue to borrow an additional £655m and refinance £450m of existing debt at lower cost.

The loan notes consist of 10 tranches as follows:

| | | | | | Principal outstanding | | |
|---|---|---|---|---|---|---|---|
| Tranche | Initial principal borrowed £m | Interest | Principal repayment period (all by instalments) | Effective interest rate % | **29 September 2018 £m** | 30 September 2017 £m | Expected WAL[a] |
| A1N | 200 | Floating | 2011 to 2028 | 6.21[b] | **131** | 142 | 6 years |
| A2 | 550 | Fixed–5.57% | 2003 to 2028 | 6.01 | **240** | 258 | 6 years |
| A3N | 250 | Floating | 2011 to 2028 | 6.29[b] | **165[c]** | 177[c] | 6 years |
| A4 | 170 | Floating | 2016 to 2028 | 5.97[b] | **150** | 159 | 6 years |
| AB | 325 | Floating | 2020 to 2032 | 6.28[b] | **325** | 325 | 10 years |
| B1 | 350 | Fixed–5.97% | 2003 to 2023 | 6.12 | **102** | 119 | 3 years |
| B2 | 350 | Fixed–6.01% | 2015 to 2028 | 6.12 | **312** | 327 | 7 years |
| C1 | 200 | Fixed–6.47% | 2029 to 2030 | 6.56 | **200** | 200 | 11 years |
| C2 | 50 | Floating | 2033 to 2034 | 6.47[b] | **50** | 50 | 15 years |
| D1 | 110 | Floating | 2034 to 2036 | 6.68[b] | **110** | 110 | 17 years |
| | 2,555 | | | | **1,785** | 1,867 | |

a. Expected weighted average life (WAL) assumes no early redemption in respect of any loan notes.
b. After the effect of interest rate swaps.
c. A3N notes are US$ notes which are shown as translated to sterling at the hedged swap rate. Values at the period end spot rate are £212m (2017 £222m). Therefore the exchange difference on the A3N notes is £47m (2017 £45m).

The notes are secured on the majority of the Group's property and future income streams therefrom. All of the floating rate notes are hedged using interest rate swaps which fix the interest rate payable.

Interest and margin is payable on the floating rate notes as follows:

| Tranche | Interest | Margin |
|---|---|---|
| A1N | 3 month LIBOR | 0.45% |
| A3N | 3 month US$ LIBOR | 0.45% |
| A4 | 3 month LIBOR | 0.58% |
| AB | 3 month LIBOR | 0.60% |
| C2 | 3 month LIBOR | 1.88% |
| D1 | 3 month LIBOR | 2.13% |

The overall cash interest rate payable on the loan notes is 6.2% (2017 6.1%) after taking account of interest rate hedging and the cost of the provision of a financial guarantee provided by Ambac in respect of the Class A and AB notes.

The securitisation is governed by various covenants, warranties and events of default, many of which apply to Mitchells & Butlers Retail Limited, the Group's main operating subsidiary. These include covenants regarding the maintenance and disposal of securitised properties and restrictions on its ability to move cash, by way of dividends for example, to other Group companies. At 29 September 2018, Mitchells & Butlers Retail Limited had cash and cash equivalents of £54m (2017 £97m). Of this amount £1m (2017 £1m), representing disposal proceeds, was held on deposit in an account over which there are a number of restrictions. The use of this cash requires the approval of the securitisation trustee and may only be used for certain specified purposes such as capital enhancement expenditure and business acquisitions.

The carrying value of the securitised debt in the Group balance sheet is analysed as follows:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Principal outstanding at beginning of period | **1,911** | 1,998 |
| Principal repaid during the period | **(82)** | (77) |
| Exchange on translation of dollar loan notes | **3** | (10) |
| Principal outstanding at end of period | **1,832** | 1,911 |
| Deferred issue costs | **(5)** | (6) |
| Accrued interest | **3** | 4 |
| Carrying value at end of period | **1,830** | 1,909 |

### Liquidity facility

Under the terms of the securitisation, the Group holds a liquidity facility of £295m provided by two counterparties. As a result of the decrease in credit rating of one of the counterparties, the Group was obliged to draw that counterparty's portion of the facility during the 52 weeks ended 27 September 2014. The amount drawn at 29 September 2018 is £147m (2017 £147m). These funds are charged under the terms of the securitisation and are not available for use in the wider Group.

The facility, which is not available for any other purpose, is sized to cover 18 months' debt service.

### Unsecured revolving credit facilities

The Group holds three unsecured committed revolving credit facilities of £50m each, and uncommitted revolving credit facilities of £15m, available for general corporate purposes. The amount drawn at 29 September 2018 is £nil (2017 £6m). All committed facilities expire on 31 December 2020.

## 4.3 Finance costs and revenue

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| **Finance costs** | | |
| Interest on securitised debt | **(114)** | (120) |
| Interest on other borrowings | **(4)** | (4) |
| Unwinding of discount on provisions (note 3.3) | **(1)** | (1) |
| Total finance costs | **(119)** | (125) |
| **Finance revenue** | | |
| Interest receivable – cash | **1** | 1 |
| **Net pensions finance charge (note 4.5)** | **(7)** | (7) |

## 4.4 Financial instruments

### Accounting policies

Financial assets and financial liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

*Financial assets*

All financial assets are recognised or derecognised on a trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned. Financial assets are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL); derivative instruments in designated hedge accounting relationships; 'held-to-maturity' investments; 'available-for-sale' (AFS) financial assets; and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

*Impairment of financial assets*

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the instrument have been affected.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the agreed credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

*Financial liabilities*

Financial liabilities are classified as either 'borrowings at amortised cost' or 'other financial liabilities'.

The borrowings accounting policy is provided in note 4.2. Other financial liabilities are initially measured at fair value, net of transaction costs.

*Derecognition of financial assets and liabilities*

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group does not retain substantially all the risks and rewards of ownership but continues to control a transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or expired. The difference between the carrying amount of the financial liability discharged and the consideration paid and payable is recognised in profit or loss.

*Effective interest method*

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating finance charges over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) over the expected life of the debt instrument, or where appropriate, a shorter period, to the net carrying amount on initial recognition. Finance charges are recognised on an effective interest basis for all debt instruments.

*Derivative financial instruments and hedge accounting*

The Group uses interest rate and currency swap contracts to hedge its exposure to changes in interest rates and exchange rates. These contracts are designated as cash flow hedges and hedge accounting is applied where the necessary criteria under IAS 39 Financial Instruments: Recognition and Measurement are met. Derivative financial instruments are not used for trading or speculative purposes.

Derivative financial instruments are initially measured at fair value on the contract date, and are re-measured to fair value at subsequent reporting dates. Fair value is calculated as the present value of the estimated future cash flows at a rate that reflects the credit risk of various counterparties.

Changes in the fair value of derivative instruments that are designated and effective as hedges of highly probable future cash flows are recognised in equity. The cumulative gain or loss is transferred from equity and recognised in the income statement at the same time as the hedged transaction affects profit or loss. The ineffective part of any gain or loss is recognised in the income statement immediately.

Movements in the fair value of derivative instruments which do not qualify for hedge accounting are recognised in the income statement immediately.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or no longer qualifies for hedge accounting. At that point, the cumulative gain or loss in equity remains in equity and is recognised in accordance with the above policy when the transaction affects profit or loss. If the hedged transaction is no longer expected to occur, the cumulative gain or loss recognised in equity is recognised in the income statement immediately.

### Financial risk management

Financial risk is managed by the Group's Treasury function. The Group's Treasury function is governed by a Board Approved Treasury Policy Statement which details the key objectives and policies for the Group's treasury management. The Treasury Committee ensures that the Treasury Policy is adhered to, monitors its operation and agrees appropriate strategies for recommendation to the Board. The Treasury Policy Statement is reviewed annually, with recommendations for change made to the Board, as appropriate. The Group Treasury function is operated as a cost centre and is the only area of the business permitted to transact treasury deals. It must also be consulted on other related matters such as the provision of guarantees or the financial implications of contract terms.

An explanation of the Group's financial instrument risk management objectives and strategies is set out below.

The main financial risks which impact the Group result from funding and liquidity risk, credit risk, capital risk and market risk, principally as a result of changes in interest and currency rates. Derivative financial instruments, principally interest rate and foreign currency swaps, are used to manage market risk. Derivative financial instruments are not used for trading or speculative purposes.

### Funding and liquidity risk

In order to ensure that the Group's long-term funding strategy is aligned with its strategic objectives, the Treasury Committee regularly assesses the maturity profile of the Group's debt, alongside the prevailing financial projections. This enables it to ensure that funding levels are appropriate to support the Group's plans.

The current funding arrangements of the Group consist of the securitised notes issued by Mitchells & Butlers Finance plc (and associated liquidity facility) along with three committed unsecured revolving credit facilities of £50m each. The terms of the securitisation and the revolving credit facilities contain various financial covenants. Compliance with these covenants is monitored by Group Treasury. The Group also has uncommitted revolving credit facilities of £15m.

The Group prepares a rolling daily cash forecast covering a six week period and an annual cash forecast by period. These forecasts are reviewed on a daily basis and are used to manage the investment and borrowing requirements of the Group. A combination of cash pooling and zero balancing agreements are in place to ensure the optimum liquidity position is maintained. The Group maintains sufficient cash balances or committed facilities outside the securitisation to ensure that it can meet its medium-term anticipated cash flow requirements.

The maturity table below details the contractual undiscounted cash flows (both principal and interest) for the Group's financial liabilities, after taking into account the effect of interest rate swaps.

| | Within one year £m | One to two years £m | Two to three years £m | Three to four years £m | Four to five years £m | More than five years £m | Total £m |
|---|---|---|---|---|---|---|---|
| **29 September 2018**[a] | | | | | | | |
| Fixed rate: Securitised debt[b] | **(195)** | **(198)** | **(201)** | **(201)** | **(200)** | **(1,687)** | **(2,682)** |
| Floating rate: Liquidity facility | **(147)** | **–** | **–** | **–** | **–** | **–** | **(147)** |
| Trade and other payables | **(302)** | **–** | **–** | **–** | **–** | **–** | **(302)** |
| **30 September 2017**[a] | | | | | | | |
| Fixed rate: Securitised debt[b] | (194) | (193) | (197) | (199) | (199) | (1,879) | (2,861) |
| Floating rate: Liquidity facility | (147) | – | – | – | – | – | (147) |
| Trade and other payables | (297) | – | – | – | – | – | (297) |

a. Assumes no early redemption in respect of any loan notes.
b. Includes the impact of the cash flow hedges.

## 4.4 Financial instruments continued

### Credit risk
The Group Treasury function enters into contracts with third parties in respect of derivative financial instruments for risk management purposes and the investment of surplus funds. These activities expose the Group to credit risk against the counterparties. To mitigate this exposure, Group Treasury operates policies that restrict the investment of surplus funds and the entering into of derivative transactions to counterparties that have a minimum credit rating of 'A' (long-term) and 'A1'/'P1'/'F1' (short-term). Counterparties may also be required to post collateral with the Group, where their credit rating falls below a predetermined level. The amount that can be invested or transacted at various ratings levels is restricted under the policy. To minimise credit risk exposure against individual counterparties, investments and derivative transactions are entered into with a range of counterparties. The Group Treasury function reviews credit ratings, as published by Moody's, Standard & Poor's and Fitch Ratings, current exposure levels and the maximum permitted exposure at given credit ratings, for each counterparty on a daily basis. Any exceptions are required to be formally reported to the Treasury Committee on a four-weekly basis.

Included in other receivables are amounts due from certain Group suppliers. Included in trade and other payables at the period end are amounts due to some of these suppliers. This reduces the Group's credit exposure.

The Group's credit exposure at the balance sheet date was:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Cash and cash equivalents | **122** | 147 |
| Other cash deposits | **120** | 120 |
| Trade receivables | **7** | 5 |
| Other receivables | **14** | 15 |
| Derivatives | **48** | 43 |

### Capital management
The Group's capital base is comprised of its net debt (analysed in note 4.1) plus total equity (disclosed on the face of the Group balance sheet). The objective is to maintain a capital base which is sufficiently strong to support the ongoing development of the business as a going concern, including the amenity, and cash flow generation of the pub estate. By keeping debt and headroom against its debt facilities at an appropriate level, the Group ensures that it maintains a strong credit position, whilst maximising value for shareholders and adhering to its covenants and other restrictions associated with its debt (see note 4.2). In managing its capital structure, from time to time the Group may realise value from non-core assets, buy back or issue new shares, initiate and vary its dividend payments and seek to vary or accelerate debt repayments. The Group's policy is to ensure that the maturity of its debt profile supports its strategic objectives. The Board considers the latest covenant compliance, headroom projections and projected balance sheet positions periodically throughout the year, based on the advice of the Treasury Committee which meets on a four-weekly basis. The Treasury Committee is chaired by the Group Treasurer and monitors Treasury performance and compliance with Board-approved policies. The Group Finance Director is also a member of the Committee.

Total capital at the balance sheet date is as follows:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Net debt (note 4.1) | **1,688** | 1,750 |
| Total equity | **1,769** | 1,626 |
| Total capital | **3,457** | 3,376 |

### Market risk
The Group is exposed to the risk that the fair value of future cash flows of its financial instruments will fluctuate because of changes in market prices. Market risk comprises foreign currency and interest rate risk.

### Foreign currency risk
The Group faces currency risk in two main areas:

At issuance of the Class A3N floating rate notes, the Group entered into a cross currency interest rate swap to manage the foreign currency exposure resulting from both the US$ principal and initial interest elements of the notes. The A3N notes have a carrying value of £212m (2017 £222m) and form part of the securitised debt (see note 4.2).

#### Sensitivity analysis
Further to the step-up on the A3N notes on 15 December 2010, the Group has additional foreign currency exposure as a result of the increase in US$ finance costs. A movement of 10% in the US$ exchange rate would have a £nil (2017 £nil) impact on the reported Group profit and a £21m (2017 £22m) impact on the reported Group net assets.

The Group has no significant profit and loss exposure as a result of retranslating monetary assets and liabilities at different exchange rates. As the Group is predominantly UK based and acquires the majority of its supplies in sterling, it has no significant direct currency exposure from its operations.

## Interest rate risk

The Group has a mixture of fixed and floating interest rate debt instruments and manages the variability in cash flows resulting from changes in interest rates by using derivative financial instruments. Where the necessary criteria are met, the Group minimises the volatility in its financial statements through the adoption of the hedge accounting provisions permitted under IAS 39. The interest rate exposure resulting from the Group's £1.9bn securitisation is largely fixed, either as a result of the notes themselves being issued at fixed interest rates, or through a combination of floating rate notes against which effective interest rate swaps are held, which are eligible for hedge accounting.

### Sensitivity analysis

The sensitivity analysis below has been calculated based on the Group's exposure to interest rates for both derivative and non-derivative instruments as at the balance sheet date. A 1% movement is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

For floating rate liabilities, which are not hedged by derivative instruments, the analysis has been prepared assuming that the liability outstanding at the balance sheet date was outstanding for the whole period. For interest income the analysis assumes that cash and cash equivalents and other cash deposits that were held in interest bearing accounts at the balance sheet date were held for the whole period.

The Group's sensitivity to a 1% movement in interest rates is detailed below:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Interest income[a] | **2** | 2 |
| Interest expense[b] | **(1)** | (2) |
| Profit impact | **1** | – |
| Derivative financial instruments (fair values)[c] | **76** | 86 |
| Total equity | **77** | 86 |

a. Represents interest income earned on cash and cash equivalents and other cash deposits (these are defined in note 4.1).
b. The element of interest expense which is not matched by payments and receipts under cash flow hedges which would otherwise offset the interest rate exposure of the Group.
c. The impact on total equity from movements in the fair value of cash flow hedges.

## Derivative financial instruments

### Cash flow hedges

Changes in cash flow hedge fair values are recognised in the hedging reserve in equity to the extent that the hedges are effective. The cash flow hedges detailed below have been assessed as being highly effective during the period and are expected to remain highly effective over the remaining contract lives.

During the period a gain of £16m (2017 gain of £60m) on cash flow hedges was recognised in equity. A loss of £34m (2017 loss of £53m) was recycled from equity and included in the Group income statement for the period.

### Cash flow hedges – securitised borrowings

At 29 September 2018, the Group held ten (2017 ten) interest rate swap contracts with a nominal value of £931m (2017 £963m), designated as a hedge of the cash flow interest rate risk of £931m (2017 £963m) of the Group's floating rate borrowings, comprising the A1N, A3N, A4, AB, C2 and D1 loan notes.

The cash flows on these contracts occur quarterly, receiving a floating rate of interest based on LIBOR and paying a fixed rate of 4.8483% (2017 4.8558%). The contract maturity dates match those of the hedged item. The ten interest rate swaps are held on the balance sheet at fair market value, which is a liability of £244m (2017 £292m).

At 29 September 2018 the Group held one (2017 one) cross currency interest rate swap contract, with a nominal value of £165m (2017 £177m), designated as a hedge of the cash flow interest rate and currency risk of the Group's A3N floating rate US$276m (2017 US$297m) borrowings. The cross currency interest rate swap is held on the balance sheet at a fair value asset of £48m (2017 £43m).

The cash flows on this contract occur quarterly, receiving a floating rate of interest based on US$ LIBOR and paying a floating rate of interest at LIBOR in sterling.

The cash flows arising from interest rate swap positions on the same counterparty may be settled as a net position. The cross currency interest rate swap is held under a separate agreement and cash movements for this instrument are settled individually.

## 4.4 Financial instruments continued

### Fair values of derivative financial instruments

The fair values of the derivative financial instruments were measured at 29 September 2018 and may be subject to material movements in the period subsequent to the balance sheet date. The fair values of the derivative financial instruments are reflected on the balance sheet as follows:

| | Derivative financial instruments – fair value | | | | |
|---|---|---|---|---|---|
| | Non-current assets £m | Current assets £m | Current liabilities £m | Non-current liabilities £m | Total £m |
| **Cash flow hedges:** | | | | | |
| – Interest rate swaps | **–** | **–** | **(37)** | **(207)** | **(244)** |
| – Cross currency swap | **44** | **4** | **–** | **–** | **48** |
| **29 September 2018** | **44** | **4** | **(37)** | **(207)** | **(196)** |
| 30 September 2017 | 41 | 2 | (43) | (249) | (249) |

### Reconciliation of movements in derivative values

The table below details changes in the Group's derivatives, including both cash and non-cash changes where appropriate. Changes in the Group's borrowings are disclosed in the net debt reconciliation in note 4.1.

| | At 24 September 2016 £m | Fair value adjustments £m | At 30 September 2017 £m | Fair value adjustments £m | **At 29 September 2018 £m** |
|---|---|---|---|---|---|
| Cash flow hedges | (351) | 102 | (249) | 53 | **(196)** |
| **Total derivatives** | (351) | 102 | (249) | 53 | **(196)** |

The fair value and carrying value of financial assets and liabilities by category is as follows:

| | **2018** | | 2017 | |
|---|---|---|---|---|
| | **Book value £m** | **Fair value £m** | Book value £m | Fair value £m |
| **Financial assets:** | | | | |
| – Cash and cash equivalents | **122** | **122** | 147 | 147 |
| – Other cash deposits | **120** | **120** | 120 | 120 |
| – Derivative instruments in designated hedge accounting relationships | **48** | **48** | 43 | 43 |
| – Loans and receivables | **21** | **21** | 20 | 20 |
| **Financial liabilities:** | | | | |
| – Borrowings at amortised cost | **(1,977)** | **(1,939)** | (2,062) | (2,076) |
| – Derivative instruments in designated hedge accounting relationships | **(244)** | **(244)** | (292) | (292) |
| – Trading and other payables | **(302)** | **(302)** | (297) | (297) |
| | **(2,212)** | **(2,174)** | (2,321) | (2,335) |

The various tranches of the securitised debt have been valued using period end quoted offer prices. As the securitised debt is traded on an active market, the market value represents the fair value of this debt. The fair value of interest rate and currency swaps is the estimated amount which the Group could expect to pay or receive on termination of the agreements. These amounts are based on quotations from counterparties which approximate to their fair market value and take into consideration interest and exchange rates prevailing at the balance sheet date. Other financial assets and liabilities are either short-term in nature or their book values approximate to fair values.

### Fair value of financial instruments

The fair value of the Group's derivative financial instruments is calculated by discounting the expected future cash flows of each instrument at an appropriate discount rate to a 'mark to market' position and then adjusting this to reflect any non-performance risk associated with the counterparties to the instrument.

IFRS 13 Financial Instruments requires the Group's derivative financial instruments to be disclosed at fair value and categorised in three levels according to the inputs used in the calculation of their fair value:

- Level 1 instruments use quoted prices as the input to fair value calculations;
- Level 2 instruments use inputs, other than quoted prices, that are observable either directly or indirectly;
- Level 3 instruments use inputs that are unobservable.

The table below sets out the valuation basis of financial instruments held at fair value by the Group:

| **Fair value at 29 September 2018** | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total £m** |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Currency swaps | **–** | **48** | **–** | **48** |
| **Financial liabilities:** | | | | |
| Interest rate swaps | **–** | **(244)** | **–** | **(244)** |
| | **–** | **(196)** | **–** | **(196)** |

| Fair value at 30 September 2017 | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **Financial assets:** | | | | |
| Currency swaps | – | 43 | – | 43 |
| **Financial liabilities:** | | | | |
| Interest rate swaps | – | (292) | – | (292) |
| | – | (249) | – | (249) |

## 4.5 Pensions

### Accounting policy

Retirement and death benefits are provided for eligible employees in the United Kingdom principally by the Mitchells & Butlers Pension Plan (MABPP) and the Mitchells & Butlers Executive Pension Plan (MABEPP). These plans are funded, HMRC approved, occupational pension schemes with defined contribution and defined benefit sections. The defined benefit section of the plans is now closed to future service accrual. The defined benefit liability relates to these funded plans, together with an unfunded unapproved pension arrangement (the Executive Top-Up Scheme, or MABETUS) in respect of certain MABEPP members. The assets of the plans are held in self-administered trust funds separate from the Company's assets.

In addition, Mitchells & Butlers plc also provides a workplace pension plan in line with the Workplace Pensions Reform Regulations. This automatically enrols all eligible workers into a Qualifying Workplace Pension Plan.

As the Company do not have an unconditional right to recover any surplus from the pension plans, IFRIC 14 requires the minimum funding liability to be recognised, where it is in excess of the actuarial liability. As such, the total pension liability recognised in the balance sheet in respect of the Group's defined benefit arrangements is the greater of the minimum funding requirements, calculated as the present value of the agreed schedule of contributions, and the actuarial calculated liability. The actuarial liability is the present value of the defined benefit obligation, less the fair value of the scheme assets. The cost of providing benefits is determined using the projected unit credit method as determined annually by qualified actuaries. This is based on a number of financial assumptions and estimates, the determination of which may be significant to the balance sheet valuation in the event that this reflects a greater deficit than that suggested by the schedule of minimum contributions.

There is no current service cost as all defined benefit schemes are closed to future accrual. The net pension finance charge, calculated by applying the discount rate to the pension deficit or surplus at the beginning of the period, is shown within finance income or expense. The administration costs of the scheme are recognised within operating costs in the income statement.

Remeasurement comprising actuarial gains and losses, the effect of minimum funding requirements, and the return on scheme assets are recognised immediately in the balance sheet with a charge or credit to the statement of comprehensive income in the period in which they occur.

Curtailments and settlements relating to the Group's defined benefit plan are recognised in the income statement in the period in which the curtailment or settlement occurs.

For the defined contribution arrangements, the charge against profit is equal to the amount of contributions payable for that period.

### Critical accounting judgements

The calculation of the defined benefit liability requires management judgement to select an appropriate high-quality corporate bond to determine the discount rate. The most significant criteria considered for the selection of bonds include the rating of the bonds and the currency and estimated term of the retirement benefit liabilities.

In addition, management have used judgement to determine the applicable rate of inflation to apply to pension increases in calculating the defined benefit obligation. Details of this are given below.

## 4.5 Pensions continued

### Measurement of scheme assets and liabilities

#### Actuarial valuation

The actuarial valuations used for IAS 19 (revised) purposes are based on the results of the latest full actuarial valuation carried out at 31 March 2016 and updated by the schemes' independent qualified actuaries to 29 September 2018. Scheme assets are stated at market value at 29 September 2018 and the liabilities of the schemes have been assessed as at the same date using the projected unit method. IAS 19 (revised) requires that the scheme liabilities are discounted using market yields at the end of the period on high-quality corporate bonds.

In relation to the MABPP, the Trust Deed and Rules provide that it is a matter for the Company to determine the rate of inflation which should be applied to pension increases for certain sections of the membership in excess of guaranteed minimum pensions and the Company has instructed the Trustee to apply CPI (subject to certain caps) in respect of such increases. The Trustee believes that this power was incorrectly vested in the Company in the Trust Deed and Rules of the MABPP in 1996 and, despite it being reflected in further versions, has made an application to court for those various Trust Deeds and Rules to be rectified. It is the Board's belief that the Company holds the power to fix such an inflation index and the Company is therefore contesting that application. The hearing is expected to be held in late 2019. The actuarial surplus as determined under IAS 19 (revised) has continued to be calculated using RPI, pending final resolution of the matter. The applicable rate of CPI at 29 September 2018 is 2.2%. Leaving all other principal financial assumptions constant, the impact of this change on the defined benefit obligation as measured under IAS 19 (revised) is estimated to be £150m. However (under IFRIC 14) an additional liability is recognised such that the total balance sheet position reflects the schedule of contributions agreed by the Company, extending to 2023. As such should the Company be successful in contesting the application there will be no necessary movement in the total balance sheet position.

The principal financial assumptions have been updated to reflect changes in market conditions in the period and are as follows:

| | **2018** | | 2017 | |
|---|---|---|---|---|
| | **Main plan** | **Executive plan** | Main plan | Executive plan |
| Discount rate* | **2.9%** | **2.9%** | 2.7% | 2.7% |
| Pensions increases – RPI max 5% | **3.0%** | **3.0%** | 3.1% | 3.1% |
| Inflation rate – RPI | **3.2%** | **3.2%** | 3.2% | 3.2% |

* The discount rate is based on a yield curve for AA corporate rated bonds which are consistent with the currency and estimated term of retirement benefit liabilities.

The mortality assumptions were reviewed following the 2016 actuarial valuation. A summary of the average life expectancies assumed is as follows:

| | **2018** | | 2017 | |
|---|---|---|---|---|
| | **Main plan years** | **Executive plan years** | Main plan years | Executive plan years |
| Male member aged 65 (current life expectancy) | **21.2** | **23.9** | 21.2 | 23.8 |
| Male member aged 45 (life expectancy at 65) | **23.0** | **25.6** | 22.9 | 25.5 |
| Female member aged 65 (current life expectancy) | **23.6** | **26.0** | 23.6 | 25.9 |
| Female member aged 45 (life expectancy at 65) | **25.5** | **27.9** | 25.4 | 27.8 |

#### Minimum funding requirements

The results of the 2016 actuarial valuation showed a funding deficit of £451m, using a more prudent basis to discount the scheme liabilities than is required by IAS 19 (revised). The Company has subsequently agreed recovery plans for both the Executive and Main schemes in order to close the funding deficit in respect of its pension liabilities. The new recovery plans show an unchanged level of cash contributions with no extension to the agreed payment term (£45m per annum indexed with RPI from 1 April 2016 subject to a minimum increase of 0% and maximum of 5%, until 31 March 2023). Under IFRIC 14, an additional liability is recognised, such that the overall pension liability at the period end reflects the schedule of contributions in relation to a minimum funding requirement, should this be higher than the actuarial deficit.

The employer contributions expected to be paid during the financial period ending 28 September 2019 amount to £49m.

In 2024, an additional payment of £13m will be made into escrow, should such further funding be required at that time. This is a contingent liability and is not reflected in the pensions liability as it is not committed.

### Sensitivity to changes in actuarial assumptions

The sensitivities regarding principal actuarial assumptions, assessed in isolation, that have been used to measure the scheme liabilities are set out below.

| | Increase or (decrease) in actuarial surplus | | Decrease or (increase) in total pension liability | |
|---|---|---|---|---|
| | **2018 £m** | 2017 £m | **2018 £m** | 2017 £m |
| 0.1% increase in discount rate | **37** | 41 | **1** | 1 |
| 0.1% increase in inflation rate | **(34)** | (36) | **(1)** | (1) |
| Additional one-year decrease to life expectancy | **72** | 77 | **1** | 1 |

The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated. In presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the statement of financial position.

There have been no changes in the methods and assumptions used in preparing the sensitivity analysis from prior periods.

### Principal risks and assumptions

The defined benefit schemes are not exposed to any unusual, entity specific or scheme specific risks but there are general risks:

**Inflation** – the majority of the plans' obligations are linked to inflation. Higher inflation will lead to increased liabilities which is partially offset by the plans holding inflation linked gilts and other inflation linked assets.

**Interest rate** – The plans' liabilities are determined using discount rates derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities though this will be partially offset by an increase in the value of the bonds held by the plans.

**Mortality** – The majority of the obligations are to provide benefits for the life of the members and their partners, so any increase in life expectancy will result in an increase in the plans' liabilities.

**Asset returns** – Assets held by the pension plans are invested in a diversified portfolio of equities, bonds and other assets. Volatility in asset values will lead to movements in the net deficit/surplus reported in the consolidated balance sheet for the plans which in addition will also impact the pension finance charge in the consolidated income statement.

### Amounts recognised in respect of defined benefit schemes

The following amounts relating to the Group's defined benefit and defined contribution arrangements have been recognised in the Group income statement and Group statement of comprehensive income:

#### Group income statement

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Operating profit: | | |
| Employer contributions (defined contribution plans) | **(8)** | (7) |
| Administrative costs (defined benefit plans) | **(2)** | (2) |
| Charge to operating profit before adjusted items | **(10)** | (9) |
| Finance costs: | | |
| Net pensions finance income/(charge) on actuarial surplus/(deficit) | **5** | (4) |
| Additional pensions finance charge due to minimum funding | **(12)** | (3) |
| Net finance charge in respect of pensions | **(7)** | (7) |
| Total charge | **(17)** | (16) |

#### Group statement of comprehensive income

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Return on scheme assets and effects of changes in assumptions | **114** | 337 |
| Movement in pension liability recognised due to minimum funding | **(109)** | (329) |
| Remeasurement of pension liability | **5** | 8 |

## 4.5 Pensions continued

### Group balance sheet

| | 2018 £m | 2017 £m |
|---|---|---|
| Fair value of scheme assets | **2,404** | 2,390 |
| Present value of scheme liabilities | **(2,068)** | (2,219) |
| Actuarial surplus in the schemes | **336** | 171 |
| Additional liability recognised due to minimum funding | **(585)** | (463) |
| Total pension liability[a] | **(249)** | (292) |
| Associated deferred tax asset | **43** | 50 |

a. The total pension liability of £249m (2017 £292m) is represented by a £49m current liability (2017 £47m) and a £200m non-current liability (2017 £245m).

The movement in the fair value of the schemes' assets in the period is as follows:

| | Scheme assets | |
|---|---|---|
| | 2018 £m | 2017 £m |
| Fair value of scheme assets at beginning of period | **2,390** | 2,381 |
| Interest income | **63** | 53 |
| Remeasurement gain: | | |
| – Return on scheme assets (excluding amounts included in net finance charge) | **23** | 3 |
| Additional employer contributions | **48** | 46 |
| Benefits paid | **(118)** | (91) |
| Administration costs | **(2)** | (2) |
| At end of period | **2,404** | 2,390 |

Changes in the present value of defined benefit obligations are as follows:

| | Defined benefit obligation | |
|---|---|---|
| | 2018 £m | 2017 £m |
| Present value of defined benefit obligation at beginning of period | **(2,219)** | (2,587) |
| Interest cost | **(58)** | (57) |
| Benefits paid | **118** | 91 |
| Remeasurement losses: | | |
| – Effect of changes in demographic assumptions | **–** | 139 |
| – Effect of changes in financial assumptions | **100** | 164 |
| – Effect of experience adjustments | **(9)** | 31 |
| At end of period[a] | **(2,068)** | (2,219) |

a. The defined benefit obligation comprises £33m (2017 £34m) relating to the MABETUS unfunded plan and £2,035m (2017 £2,185m) relating to the funded plans.

The weighted average duration of the defined benefit obligation is 20 years (2017 20 years).

The major categories and fair values of assets of the MABPP and MABEPP schemes at the end of the reporting period are as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| Cash and equivalents | **111** | 18 |
| Equity instruments | **626** | 730 |
| Debt instruments: | | |
| – Bonds | **1,513** | 1,512 |
| – Real estate debt | **76** | 90 |
| – Infrastructure debt | **95** | 73 |
| – Secured income debt | **80** | – |
| – Absolute return bond funds | **202** | 200 |
| – Gilt repurchase transactions | **(303)** | (245) |
| Gold | **8** | 4 |
| Forward foreign exchange contracts | **(4)** | 8 |
| Fair value of assets | **2,404** | 2,390 |

The actual investment return achieved on the scheme assets over the period was 4.3% (2017 2.2%), which represented a gain of £86m (2017 £56m).

Virtually all equity instruments, bonds and gold have quoted prices in active markets and are classified as Level 1 instruments. Absolute return bond funds, gilt repurchase transactions and forward foreign exchange contracts are classified as Level 2 instruments. Real estate debt and infrastructure debt are classified as Level 3 instruments.

In the 52 weeks ended 29 September 2018 the Group paid £7m (2017 £7m) in respect of the defined contribution arrangements, with an additional £2m (2017 £1m) outstanding as at the period end.

At 29 September 2018 the MABPP owed £1m (2017 £2m) to the Group in respect of expenses paid on its behalf. This amount is included in other receivables in note 3.2.

## 4.6 Share-based payments

### Accounting policy

The Group operates a number of equity-settled share-based compensation plans, whereby, subject to meeting any relevant conditions, employees are awarded shares or rights over shares. The cost of such awards is measured at fair value, excluding the effect of non market-based vesting conditions, on the date of grant. The expense is recognised on a straight-line basis over the vesting period and is adjusted for the estimated effect of non market-based vesting conditions and forfeitures, on the number of shares that will eventually vest due to employees leaving the employment of the Group. Fair values are calculated using either the Black-Scholes, Binomial or Monte Carlo simulation models depending on the conditions attached to the particular share scheme.

SAYE share options granted to employees are treated as cancelled when employees cease to contribute to the scheme. This results in an accelerated recognition of the expense that would have arisen over the remainder of the original vesting period.

### Schemes in operation

The net charge recognised for share-based payments in the period was £3m (2017 £2m).

The Group had four equity-settled share schemes (2017 four) in operation during the period; the Performance Restricted Share Plan (PRSP); Sharesave Plan; Share Incentive Plan (SIP) and Short Term Deferred Incentive Plan (STDIP).

The vesting of all awards or options is generally dependent upon participants remaining in the employment of a participating company during the vesting period. Further details on each scheme are provided in the Report on Directors' remuneration on pages 68 to 91.

The following tables set out weighted average information about how the fair value of each option grant was calculated:

| | **2018** | | 2017 | |
|---|---|---|---|---|
| | **Performance Restricted Share Plan** | **Sharesave Plan** | Performance Restricted Share Plan | Sharesave Plan |
| Valuation model | **Monte Carlo and Binomial** | **Black-Scholes** | Monte Carlo and Binomial | Black-Scholes |
| Weighted average share price | **259.2p** | **264.2p** | 246.1p | 231.0p |
| Exercise price[a] | **–** | **246.0p** | – | 221.0p |
| Expected dividend yield[b] | **–** | **1.97%** | – | 2.94% |
| Risk-free interest rate | **0.68%** | **0.86%** | 0.34% | 0.31% |
| Volatility[c] | **32.5%** | **31.0%** | 32.0% | 29.43% |
| Expected life (years)[d] | **2.4** | **4.0** | 3.5 | 4.10 |
| Weighted average fair value of grants during the period | **224.2** | **61.3** | 182.4 | 42.8 |

a. The exercise price for the Performance Restricted Share Plan is £1 per participating employee.
b. The expected dividend yield for the Sharesave Plan has used historical dividend information. For details on the Group's current dividend policy refer to the Financial review on page 45. The expected dividend yield for the Performance Restricted Share Plan options is zero as participants are entitled to Dividend Accrued Shares to the value of ordinary dividends paid or payable during the vesting period.
c. The expected volatility is determined by calculating the historical volatility of the Company's share price commensurate with the expected term of the options and share awards.
d. The expected life of the options represents the average length of time between grant date and exercise date.

The fair value of awards under the Short Term Deferred Incentive Plan and the Share Incentive Plan are equal to the share price on the date of award as there is no price to be paid and employees are entitled to Dividend Accrued Shares to the value of ordinary dividends paid or payable during the vesting period. The assumptions set out above are therefore not relevant to these schemes. The fair value of options granted under the Share Incentive Plan during the period was 264.2p (2017 231.0p).

## 4.6 Share-based payments continued

The tables below summarise the movements in outstanding options during the period.

| | Number of shares | | Weighted average exercise price | |
|---|---|---|---|---|
| | **2018 m** | 2017 m | **2018 p** | 2017 p |
| **Sharesave plan** | | | | |
| Outstanding at the beginning of the period | **4.1** | 3.6 | **264.1** | 297.0 |
| Granted | **1.3** | 1.8 | **246.0** | 221.0 |
| Exercised | **(0.1)** | (0.1) | **182.2** | 249.0 |
| Forfeited | **(0.8)** | (0.8) | **257.3** | 296.8 |
| Expired | **(0.4)** | (0.4) | **323.5** | 302.6 |
| Outstanding at the end of the period | **4.1** | 4.1 | **256.0** | 264.1 |
| Exercisable at the end of the period | **–** | 0.5 | **–** | 291.1 |

The outstanding options for the SAYE scheme had an exercise price of between 221.0p and 362.0p (2017 between 182.0p and 362.0p) and the weighted average remaining contract life was 2.8 years (2017 3.0 years). The number of forfeited shares in the period includes 545,646 (2017 615,998) cancellations.

SAYE options were exercised on a range of dates. The average share price through the period was 258.4p (2017 251.1p).

| | Number of shares | |
|---|---|---|
| | **2018 m** | 2017 m |
| **Share Incentive Plan** | | |
| Outstanding at the beginning of the period | **1.7** | 1.5 |
| Granted | **0.4** | 0.5 |
| Exercised | **(0.2)** | (0.2) |
| Forfeited | **(0.1)** | (0.1) |
| Outstanding at the end of the period | **1.8** | 1.7 |
| Exercisable at the end of the period | **0.8** | 0.8 |

Options under the Share Incentive Plan are capable of remaining within the SIP trust indefinitely while participants continue to be employed.

| | Number of shares | |
|---|---|---|
| | **2018 m** | 2017 m |
| **Performance Restricted Share Plan** | | |
| Outstanding at the beginning of the period | **5.2** | 4.1 |
| Granted | **2.2** | 2.1 |
| Forfeited | **(0.2)** | (0.1) |
| Expired | **(1.1)** | (0.9) |
| Outstanding at the end of the period | **6.1** | 5.2 |
| Exercisable at the end of the period | **–** | – |

The exercise price for the Performance Restricted Share Plan is £1 per participating employee, therefore the weighted average exercise price for these options is £nil (2017 £nil).

Options outstanding at 29 September 2018 had an exercise price of £nil and a weighted average remaining contractual life of 3.2 years (2017 3.3 years).

## 4.7 Equity

**Accounting policies**

*Own shares*

The cost of own shares held in employee share trusts and in treasury are deducted from shareholders' equity until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, the fair value of any consideration received is also included in shareholders' equity.

*Dividends*

Dividends proposed by the Board but unpaid at the period end are not recognised in the financial statements until they have been approved by shareholders at the Annual General Meeting. Interim dividends are recognised when paid.

Scrip dividends are fully paid up from the share premium account. They are accounted for as an increase in share capital for the nominal value of the shares issued, and a resulting reduction in share premium.

### Called up share capital

| | 2018 Number of shares | 2018 £m | 2017 Number of shares | 2017 £m |
|---|---|---|---|---|
| **Allotted, called up and fully paid** | | | | |
| Ordinary shares of 8 13/24p each | | | | |
| At start of period | **422,548,604** | **36** | 413,624,294 | 35 |
| Share capital issued[a] | **5,762,219** | **1** | 8,924,310 | 1 |
| **At end of period** | **428,310,823** | **37** | 422,548,604 | 36 |

a. Under the terms of the Company's scrip dividend scheme, shareholders are able to elect to receive ordinary shares in place of both interim and final dividends. This has resulted in the issue of 5,354,617 new fully paid ordinary shares in relation to the final dividend for the 53 weeks ended 30 September 2017 (2017 8,506,296). There was no interim dividend declared in the current period. In addition, the Company issued 407,602 (2017 418,014) shares during the period under share option schemes for a consideration of £nil (2017 £nil).

All of the ordinary shares rank equally with respect to voting rights and rights to receive ordinary and special dividends. There are no restrictions on the rights to transfer shares.

Details of options granted under the Group's share schemes are contained in note 4.6.

### Dividends

| | 2018 Cash dividend £m | 2018 Settled via scrip £m | 2018 Total dividend £m | 2017 Cash dividend £m | 2017 Settled via scrip £m | 2017 Total dividend £m |
|---|---|---|---|---|---|---|
| **Declared and paid in the period** | | | | | | |
| Final dividend of 5.0p per share – 53 weeks ended 30 September 2017 | **7** | **14** | **21** | – | – | – |
| Interim dividend of 2.5p per share – 53 weeks ended 30 September 2017 | **–** | **–** | **–** | 8 | 3 | 11 |
| Final dividend of 5.0p per share – 52 weeks ended 24 September 2016 | **–** | **–** | **–** | 4 | 17 | 21 |
| | **7** | **14** | **21** | 12 | 20 | 32 |

The final dividend of 5.0p per ordinary share declared in relation to the 53 weeks ended 30 September 2017 was approved at the Annual General Meeting on 23 January 2018 and was paid to shareholders on 6 February 2018. Shareholders were able to elect to receive ordinary shares credited as fully paid instead of the cash dividend under the terms of the Company's scrip dividend scheme. Of the £21m final dividend, £14m was in the form of the issue of ordinary shares to shareholders opting in to the scrip alternative. The market value per share at the date of payment was 264.4p per share, resulting in the issue of 5 million new shares, fully paid up from the share premium account. The nominal value of the 5 million shares issued in relation to the final scrip dividends is £1m.

### 4.7 Equity continued

#### Share premium account
The share premium account represents amounts received in excess of the nominal value of shares on issue of new shares. Share premium of £1m has been recognised on shares issued in the period (2017 £nil).

#### Capital redemption reserve
The capital redemption reserve movement arose on the repurchase and cancellation by the Company of ordinary shares during prior periods.

#### Revaluation reserve
The revaluation reserve represents the unrealised gain generated on revaluation of the property estate with effect from 29 September 2007. It comprises the excess of the fair value of the estate over deemed cost, net of related deferred taxation.

#### Own shares held
Own shares held by the Group represent the shares in the Company held by the employee share trusts.

During the period, the employee share trusts acquired no shares (2017 nil) and subscribed for 296,144 (2017 353,025) shares at a cost of £nil (2017 £nil) and released 159,956 (2017 188,586) shares to employees on the exercise of options and other share awards for a total consideration of £nil (2017 £nil). The 1,885,130 shares held by the trusts at 29 September 2018 had a market value of £5m (30 September 2017 1,748,942 shares held had a market value of £5m).

The Company has established two employee share trusts:

#### Share Incentive Plan (SIP) Trust
The SIP Trust was established in 2003 to purchase shares on behalf of employees participating in the Company's Share Incentive Plan. Under this scheme, eligible employees are awarded free shares which are normally held in trust for a holding period of at least three years. After five years the shares may be transferred to or sold by the employee free of income tax and National Insurance contributions. The SIP Trust buys the shares in the market or subscribes for newly issued shares with funds provided by the Company. During the holding period, dividends are paid directly to the participating employees. At 29 September 2018, the trustees, Equiniti Share Plan Trustees Limited, held 1,847,623 (2017 1,698,880) shares in the Company. Of these shares, 583,410 (2017 553,839) shares are unconditionally available to employees, 245,415 (2017 272,341) shares have been conditionally awarded to employees, 982,143 (2017 842,954) shares have been awarded to employees but are still required to be held within the SIP Trust and the remaining 36,655 (2017 29,746) shares are unallocated.

#### Employee Benefit Trust (EBT)
The EBT was established in 2003 in order to satisfy the exercise or vesting of existing and future share options and awards under the Executive Share Option Plan, Performance Restricted Share Plan, Short Term Deferred Incentive Plan and the Sharesave Plan. The EBT purchases shares in the market or subscribes for newly issued shares, using funds provided by the Company, based on expectations of future requirements. Dividends are waived by the EBT. At 29 September 2018, the trustees, Sanne Fiduciary Services Limited, were holding 37,507 (2017 50,062) shares in the Company.

#### Hedging reserve
The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged future cash flows.

#### Translation reserve
The translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries.

#### Retained earnings
The Group's main operating subsidiary, Mitchells & Butlers Retail Limited, had retained earnings under FRS 101 of £2,199m at 29 September 2018 (2017 £2,157m). Its ability to distribute these reserves by way of dividends is restricted by the securitisation covenants (see note 4.2).

## 5.1 Related party transactions

### Key management personnel

Employees of the Mitchells & Butlers plc Group who are members of the Board of Directors or the Executive Committee of Mitchells & Butlers plc are deemed to be key management personnel. It is the Board who have responsibility for planning, directing and controlling the activities of the Group.

Compensation of key management personnel of the Group:

| | **2018 52 weeks £m** | 2017 53 weeks £m |
|---|---|---|
| Short-term employee benefits | **4** | 4 |

Movements in share options held by the Directors of Mitchells & Butlers plc are summarised in the Report on Directors' remuneration.

## 5.2 Subsidiaries and associates

### Subsidiaries

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation.

Mitchells & Butlers plc is the beneficial owner of all of the equity share capital, either itself or through subsidiary undertakings, of the following companies:

| Name of subsidiary | Country of incorporation | Country of operation | Nature of business |
|---|---|---|---|
| **Principal operating subsidiaries** | | | |
| Mitchells & Butlers Retail Limited | England and Wales | United Kingdom | Leisure retailing |
| Mitchells & Butlers Retail (No. 2) Limited | England and Wales | United Kingdom | Leisure retailing |
| Ha Ha Bar & Grill Limited | England and Wales | United Kingdom | Leisure retailing |
| Orchid Pubs & Dining Limited | England and Wales | United Kingdom | Leisure retailing |
| ALEX Gaststätten Gesellschaft mbH & Co KG | Germany | Germany | Leisure retailing |
| Midco 1 Limited | England and Wales | United Kingdom | Property leasing company |
| Mitchells & Butlers (Property) Limited | England and Wales | United Kingdom | Property management |
| Mitchells & Butlers Leisure Retail Limited | England and Wales | United Kingdom | Service company |
| Mitchells & Butlers Germany GmbH[a] | Germany | Germany | Service company |
| Mitchells & Butlers Finance plc | England and Wales | United Kingdom | Finance company |
| Standard Commercial Property Developments Limited | England and Wales | United Kingdom | Property development |
| **Other subsidiaries** | | | |
| Mitchells & Butlers Holdings (No.2) Limited[a] | England and Wales | United Kingdom | Holding company |
| Mitchells & Butlers Holdings Limited | England and Wales | United Kingdom | Holding company |
| Mitchells & Butlers Leisure Holdings Limited | England and Wales | United Kingdom | Holding company |
| Mitchells & Butlers Retail Holdings Limited | England and Wales | United Kingdom | Holding company |
| Old Kentucky Restaurants Limited | England and Wales | United Kingdom | Trademark ownership |
| Bede Retail Investments Limited | England and Wales | United Kingdom | Non-trading |
| Lastbrew Limited | England and Wales | United Kingdom | Non-trading |
| Mitchells & Butlers (IP) Limited | England and Wales | United Kingdom | Non-trading |
| Mitchells & Butlers Acquisition Company | England and Wales | United Kingdom | Non-trading |
| Mitchells & Butlers Retail Property Limited[a] | England and Wales | United Kingdom | Non-trading |
| Mitchells and Butlers Healthcare Trustee Limited | England and Wales | United Kingdom | Healthcare trustee |
| Standard Commercial Property Investments Limited | England and Wales | United Kingdom | Non-trading |
| Standard Commercial Property Securities Limited | England and Wales | United Kingdom | Non-trading |
| Temple Circus Developments Limited | England and Wales | United Kingdom | Non-trading |
| ALEX Gaststätten Immobiliengesellschaft mbH | Germany | Germany | Property management |
| ALL BAR ONE Gaststätten Betriebsgesellschaft mbH | Germany | Germany | Leisure retailing |
| ALEX Alsterpavillon Immobilien GmbH & Co KG | Germany | Germany | Property management |
| ALEX Alsterpavillon Management GmbH | Germany | Germany | Management company |
| ALEX Gaststätten Management GmbH | Germany | Germany | Management company |
| PLAN-BAR Gastronomie Einrichtungs GmbH | Germany | Germany | Non-trading |
| Browns Restaurant (Brighton) Limited | England and Wales | United Kingdom | Dormant |
| Browns Restaurant (Bristol) Limited | England and Wales | United Kingdom | Dormant |
| Browns Restaurant (Cambridge) Limited | England and Wales | United Kingdom | Dormant |
| Browns Restaurant (London) Limited | England and Wales | United Kingdom | Dormant |
| Browns Restaurant (Oxford) Limited | England and Wales | United Kingdom | Dormant |

### 5.2 Subsidiaries and associates continued

| Name of subsidiary | Country of incorporation | Country of operation | Nature of business |
|---|---|---|---|
| Browns Restaurants Limited | England and Wales | United Kingdom | Dormant |
| Crownhill Estates (Derriford) Limited | England and Wales | United Kingdom | Dormant |
| East London Pubs & Restaurants Limited | England and Wales | United Kingdom | Dormant |
| Mitchells & Butlers Lease Company Limited | England and Wales | United Kingdom | Dormant |
| Intertain (Dining) Limited | England and Wales | United Kingdom | Dormant |
| Lander & Cook Limited[b] | England and Wales | United Kingdom | Dormant |

a. Shares held directly by Mitchells & Butlers plc.
b. Incorporated on 3 January 2018.

The registered office for companies operating in the United Kingdom is 27 Fleet Street, Birmingham, B3 1JP.

The registered office for companies operating in Germany is Adolfstrasse 16, 65185 Wiesbaden.

#### Associates

Details of the Company's associates, held indirectly, are as follows. Shares in these associates have been acquired in the period.

| Name of associate | Registered office | Country of incorporation and operation | Country of operation | Nature of business | Proportion of ownership interest % | Proportion of voting power interest % |
|---|---|---|---|---|---|---|
| 3Sixty Restaurants Limited | 1st Floor St Georges House, St Georges Road, Bolton, BL1 2DD | England and Wales | United Kingdom | Leisure retailing | 40 | 40 |
| Fatboy Pub Company Limited | Ampney House, Falcon Close, Quedgeley, Gloucester, GL2 4LS | England and Wales | United Kingdom | Leisure retailing | 25 | 25 |

### 5.3 Events after the balance sheet date

On 26 October 2018 the High Court provided a ruling regarding guaranteed minimum pensions (GMPs) equalisation. The court ruled that pensions provided to members who had contracted-out of their scheme must be recalculated to ensure payments reflect the equalisation of state pension ages in the 1990s. The ruling confirmed that there are four methods of equalising GMP that are lawful in principle, but importantly employers can direct trustees to apply 'method C' i.e. provide the better of male or female comparator pensions each year, subject to accumulated offsetting. The court also ruled that trustees are obliged to make arrears payments to members and simple interest on the arrears should be paid at 1% above the base rate.

This ruling will impact the Group's actuarial surplus/(deficit), as it will lead to an increase in pension obligations, however it should be noted that due to the recognition of an additional liability in relation to minimum funding, there will be no change to the reported pension position on the balance sheet. As the Trustee's have not previously attempted to equalise GMPs, the ruling is treated as a non-adjusting event.

Given the date of the ruling and complexity of application, it is not currently practical to estimate the impact on the actuarial surplus/(deficit) and income statement.

### 5.4 Five year review

| | **2018 52 weeks £m** | 2017 53 weeks £m | 2016 52 weeks £m | 2015 52 weeks £m | 2014 52 weeks £m |
|---|---|---|---|---|---|
| **Revenue** | **2,152** | 2,180 | 2,086 | 2,101 | 1,970 |
| **Operating profit before adjusted items** | **303** | 314 | 318 | 328 | 313 |
| Adjusted items | **(48)** | (106) | (87) | (58) | (49) |
| **Operating profit** | **255** | 208 | 231 | 270 | 264 |
| Finance costs | **(119)** | (125) | (126) | (130) | (132) |
| Finance revenue | **1** | 1 | 1 | 1 | 1 |
| Net pensions finance charge | **(7)** | (7) | (12) | (15) | (10) |
| **Profit before taxation** | **130** | 77 | 94 | 126 | 123 |
| Tax expense | **(26)** | (14) | (5) | (23) | (30) |
| **Profit for the period** | **104** | 63 | 89 | 103 | 93 |
| **Earnings per share** | | | | | |
| Basic | **24.5p** | 15.1p | 21.6p | 25.0p | 22.6p |
| Diluted | **24.4p** | 15.0p | 21.6p | 24.9p | 22.5p |
| Adjusted (Basic)[a] | **34.1p** | 34.9p | 34.9p | 35.7p | 32.6p |

a. Adjusted earnings per share is stated after removing the impact of adjusted items as explained in note 2.2.

# Company balance sheet

29 September 2018

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Investments in subsidiaries | 5 | **1,474** | 1,474 |
| Deferred tax asset | 9 | **48** | 56 |
| | | **1,522** | 1,530 |
| **Current assets** | | | |
| Trade and other receivables | 6 | **739** | 828 |
| Cash and cash equivalents | | **14** | 1 |
| | | **753** | 829 |
| **Current liabilities** | | | |
| Pension liabilities | 4 | **(49)** | (47) |
| Borrowings | 8 | **(28)** | (28) |
| Trade and other payables | 7 | **(288)** | (419) |
| | | **(365)** | (494) |
| **Non-current liabilities** | | | |
| Pension liabilities | 4 | **(200)** | (245) |
| **Net assets** | | **1,710** | 1,620 |
| | | | |
| **Equity** | | | |
| Called up share capital | 10 | **37** | 36 |
| Share premium account | | **26** | 26 |
| Capital redemption reserve | | **3** | 3 |
| Own shares held | | **(1)** | (1) |
| Retained earnings | | **1,645** | 1,556 |
| **Total equity** | | **1,710** | 1,620 |

The Company reported profit for the 52 weeks ended 29 September 2018 of £89m (53 weeks ended 30 September 2017 £121m).

The financial statements were approved by the Board and authorised for issue on 21 November 2018.

They were signed on its behalf by:

**Tim Jones Finance Director**

The accounting policies and the notes on pages 145 to 147 form an integral part of these financial statements.

Registered Number: 04551498

## Company statement of changes in equity

For the 52 weeks ended 29 September 2018

| | Share capital £m | Share premium £m | Capital redemption reserve £m | Own shares held £m | Retained earnings £m | Total equity £m |
|---|---|---|---|---|---|---|
| **At 24 September 2016** | 35 | 27 | 3 | (1) | 1,438 | 1,502 |
| Profit after taxation | – | – | – | – | 121 | 121 |
| Remeasurement of pension liability | – | – | – | – | 8 | 8 |
| Deferred tax on remeasurement of pension liability | – | – | – | – | (1) | (1) |
| Total comprehensive income | – | – | – | – | 128 | 128 |
| Credit in respect of employee share schemes | – | – | – | – | 2 | 2 |
| Dividends paid | – | – | – | – | (12) | (12) |
| Scrip dividend related share issue | 1 | (1) | – | – | – | – |
| **At 30 September 2017** | 36 | 26 | 3 | (1) | 1,556 | 1,620 |
| Profit after taxation | – | – | – | – | 89 | 89 |
| Remeasurement of pension liability | – | – | – | – | 5 | 5 |
| Deferred tax on remeasurement of pension liability | – | – | – | – | (1) | (1) |
| Total comprehensive income | – | – | – | – | 93 | 93 |
| Share capital issued | – | 1 | – | – | – | 1 |
| Credit in respect of employee share schemes | – | – | – | – | 3 | 3 |
| Dividends paid | – | – | – | – | (7) | (7) |
| Scrip dividend related share issue | 1 | (1) | – | – | – | – |
| **At 29 September 2018** | **37** | **26** | **3** | **(1)** | **1,645** | **1,710** |

The retained earnings account is wholly distributable after the deduction for own shares.

## 1. Basis of preparation

### Basis of accounting

These financial statements were prepared in accordance with Financial Reporting Standard 101 'Reduced Disclosure Framework' as issued by the FRC.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, presentation of a cash flow statement, standards not yet effective, impairment of assets and related party transactions. Where required, equivalent disclosures are given in the consolidated financial statements.

The financial statements have been prepared under the historical cost convention. The Company's accounting policies have been applied on a consistent basis to those set out in the relevant notes to the consolidated financial statements. There have been no changes to policies during the period. The critical judgements and estimates of the Company are considered alongside those of the Group. The key critical judgement of the Company is related to the selection of the discount rate and inflation rate assumptions used in the calculation of the defined benefit pension liability described in note 4.5 of the consolidated financial statements. The key critical estimates for the Company are the estimate of future cash flows and the selection of discount rate in the investment impairment review described in note 5.

### Foreign currencies

Transactions in foreign currencies are recorded at the exchange rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange ruling at the balance sheet date.

## 2. Profit and loss account

### Profit and loss account

The Company has not presented its own profit and loss account, as permitted by Section 408 of the Companies Act 2006.

The Company recorded a profit after tax of £89m (2017 £121m), less dividends of £7m (2017 £12m). Dividends are disclosed in note 4.7 of the consolidated financial statements.

### Audit remuneration

Auditor's remuneration for audit services to the Company was £22,000 (2017 £22,000). This is borne by another Group company, as are any other costs relating to non-audit services (see note 2.3 to the consolidated financial statements).

## 3. Employees and Directors

| | **2018 52 weeks** | 2017 53 weeks |
|---|---|---|
| Average number of employees, including part-time employees | **2** | 2 |

Employees of Mitchells & Butlers plc consist of Executive Directors who are considered to be the key management personnel of the Company.

Details of employee benefits and post-employment benefits, including share-based payments, are included within the Report on Directors' remuneration on pages 68 to 91. The charge recognised for share-based payments in the period is £nil (2017 £nil).

## 4. Pensions

### Accounting policy

The accounting policy for pensions is disclosed in the consolidated financial statements in note 4.5.

### Pension liability

At 29 September 2018 the Company's pension liability was £249m (2017 £292m). Of this amount, £49m (2017 £47m) is a current liability and £200m (2017 £245m) is a non-current liability.

The Company is the sponsoring employer of the Group's pension plans. Information concerning the pension scheme arrangements operated by the Company and associated current and future contributions is contained within note 4.5 to the consolidated financial statements on pages 133 to 137.

The pension amounts and disclosures included in note 4.5 to the consolidated financial statements are equivalent to those applicable for the Company.

## 5. Investments in subsidiaries

### Accounting policy

The Company's investments in Group undertakings are held at cost less provision for impairment, except for those amounts designated as being in a fair value hedge.

### Critical accounting estimates

The application of the impairment methodology requires two critical accounting estimates; the forecast of cash flows and the selection of an appropriate discount rate. A sensitivity analysis of changes in cash flows and the discount rate in relation to the investments to which these estimates apply, is provided below.

| | Shares in subsidiary undertakings £m |
|---|---|
| **Cost** | |
| At 24 September 2016 | 3,104 |
| Exchange differences | 1 |
| Additions[a] | 248 |
| **At 30 September 2017** | 3,353 |
| Exchange differences | – |
| **At 29 September 2018** | **3,353** |
| | |
| **Provision** | |
| At 24 September 2016 | 1,879 |
| Impairment | – |
| **At 30 September 2017** | 1,879 |
| Impairment | – |
| **At 29 September 2018** | **1,879** |
| | |
| **Net book value** | |
| **At 29 September 2018** | **1,474** |
| | |
| At 30 September 2017 | 1,474 |
| | |
| At 24 September 2016 | 1,225 |

a. Additions in the prior period of £248m relate to a capital contribution, in the form of a loan waiver, provided to a subsidiary company within the Mitchells & Butlers plc Group. The intercompany loan was tested for impairment prior to the loan waiver, with no impairment required.

Mitchells & Butlers plc is the beneficial owner of all of the equity share capital of companies within the Group, either itself or through subsidiary undertakings. In addition, the Company has indirect investments in associate companies through subsidiary undertakings. See note 5.2 of the consolidated financial statements for a full list of subsidiaries and associates.

Investments have been tested for impairment using forecast cash flows, discounted by applying a pre-tax discount rate of 7.7% (2017 7.5%). For the purposes of the calculation of the recoverable amount, the cash flow projections include 0.0% (2017 0.0%) of growth per annum.

### Sensitivity analysis

The Company has performed a sensitivity analysis on the impairment tests for its investments in subsidiaries using various reasonably possible scenarios. It is estimated that neither a 0.5% increase in the discount rate nor a 5% reduction in future cash flows would generate an impairment charge.

## 6. Trade and other receivables

| | **2018 £m** | 2017 £m |
|---|---|---|
| Amounts owed by subsidiary undertakings | **739** | 828 |

Amounts owed by subsidiary undertakings are repayable on demand. Interest is not charged on all balances. Where interest is charged, it is charged at market rate, based on what can be achieved on corporate deposits.

## 7. Trade and other payables

| | 2018 £m | 2017 £m |
|---|---|---|
| Amounts owed to subsidiary undertakings[a] | **283** | 416 |
| Accrued charges | **4** | – |
| Other payables | **1** | 3 |
| | **288** | 419 |

a. Amounts owed to subsidiary undertakings are repayable on demand. Interest is not charged on all balances. Where interest is charged, it is charged at market rate, based on what can be achieved on corporate deposits.

## 8. Borrowings

### Accounting policy
The accounting policy for borrowings is disclosed in the consolidated financial statements in note 4.2.

Borrowings can be analysed as follows:

| | 2018 £m | 2017 £m |
|---|---|---|
| **Current** | | |
| Bank overdraft | **28** | 28 |
| Total borrowings | **28** | 28 |

### Unsecured revolving credit facility
The Company holds uncommitted credit facilities of £15m. The amount drawn at 29 September 2018 is £nil (2017 £nil).

## 9. Taxation

### Accounting policy
The accounting policy for taxation is disclosed in the consolidated financial statements in note 2.4.

### Deferred tax asset
Movements in the deferred tax asset can be analysed as follows:

| | £m |
|---|---|
| At 24 September 2016 | 66 |
| Charged to income statement – pensions | (6) |
| Charged to income statement – tax losses | (3) |
| Charged to other comprehensive income – pensions | (1) |
| At 30 September 2017 | 56 |
| Charged to income statement – pensions | (6) |
| Charged to income statement – tax losses | (1) |
| Charged to other comprehensive income – pensions | (1) |
| **At 29 September 2018** | **48** |

Analysed as tax timing differences related to:

| | 2018 £m | 2017 £m |
|---|---|---|
| Pensions | **43** | 50 |
| Tax losses[a] | **5** | 6 |
| | **48** | 56 |

a. Tax losses arising in 2008 which are now recoverable by offset against other income.

Further information on the changes to tax legislation are provided in note 2.4 to the consolidated financial statements.

## 10. Equity

### Called up share capital
Details of the amount and nominal value of allotted, called up and fully paid share capital are contained in note 4.7 to the consolidated financial statements.

### Dividends
Details of the dividends declared and paid by the Company are contained in note 4.7 to the consolidated financial statements.