Mitchells & Butlers

Corporate Participants

John Lovering

Mitchells & Butlers plc- Chairman

Adam Fowle

Mitchells & Butlers plc- Chief Executive

Jeremy Townsend

Mitchells & Butlers plc- Finance Director

Presentation

Operator

Thank you for standing by and welcome to the Mitchells & Butlers Strategy Review conference call. There will be a presentation followed by a question and answer session at which time if you wish to ask a question you will need to press *1 on your telephone. I must advise you that this conference is being recorded today, Wednesday 24th March 2010. I would now like to hand the conference over to your speaker today, John Lovering. Please go ahead sir.

John Lovering

Thank you. Yes, John Lovering here and I am joined by the Executive team, Adam Fowle, Jeremy Townsend. First of all I would like to thank you for joining the call. Today as you know we published the results of the strategic review which we said we would complete by the end of March. The Board have worked very hard and very cohesively on this and the Non-Execs have been fully involved in contributing. I would like to thank them and all our executive colleagues for their commitment and energy, and I also want to thank particularly the teams in our business, the bedrock of our success, that has kept delivering great products and great service over the last period despite the number of column inches we've generated over the last year or two.

The strategy set out is an acceleration, not a revolution. The principal direction is to rapidly reshape Mitchells & Butlers into a food led business centred around a number of core concepts, certainly six as a minimum, which have significant growth potential. We will plan a withdrawal from the more price sensitive drinks led business. Underlying both of these themes is a view that

we must optimise our brands, not optimise our property. Traditionally, pub companies have sought ways of fully occupying their estate and this has led to a proliferation of brands and activity. We want to take our consumer offers to where consumers wish to consume food and drink, whether that be leisure parks, retail parks, or ultimately the High Street.

We plan to improve our key operating ratios, especially net operating margins. Food margins in particular have come under considerable pressure in this business over the last two or three years. Our strategy, which may well have been correct for the times of aggressively building market share has now seen us with opportunities to increase margins. I would stress this won't be achieved by crude price increases, but we do think there are considerable opportunities in the business to increase average transaction value.

We also can see opportunities as we simplify the business to reduce cost in certain areas. For example, at the moment our overhead ratio is about 4.3% of sales, massively improved on 2006, but we still believe there is scope to reach industry best practice at around 3.75% of sales. We can see opportunities to take £10 million or more out of the purchasing cost of goods not for resale and the cost of operating our supply chain which has been high by industry standards.

But this plan, I would stress, is about growth and repositioning, not about cost reduction because we won't create substantial amounts of shareholder value by one off cost reduction, it has to be growing the top line and improving the margins.

We want to improve capital returns. We have set new hurdle rates for capital expenditure in the business, we will continue to spend about 6% for turnover, £120 million a year, on maintaining and developing our existing estate, but we do need to be much more explicit on the returns we are seeking as a freehold property owner, an investor in infrastructure, and an investor in riskier retail facing capital investment. So we have set new hurdle rates to achieve that. As part of this focus on returns in the different activities in the business we are going to be explicit in splitting the returns and assets deployed in our property business and in our retail business. A strict regime of internal rents will be imposed and we will be very clear on whether we are making money as a landlord or as a retail trader. In my view this is absolutely critical to managing property intensive businesses properly.

In terms of the balance sheet, the securitised debt which the Company has is a most attractive asset; the terms both in terms of cost, flexibility and term are very attractive and we will manage our strategy in a way that doesn't compromise the continuity of the securitisation. We are

comfortable with debt at around five times EBITDA and certainly at the moment see no need to have recourse to any other source of capital.

The other major headline is that we want to move the basis of paying culture to one which encourages an entrepreneurial approach to creating shareholder value. As it says in the body of the text, this Company - and this isn't a criticism, it is an observation – that senior management in M&B would be rational if they valued their pension entitlement more fully than they do their share options or their shares. We have got to do something to redress that balance to get full alignment between senior executives and shareholders to make sure the focus is on creating value, not seeing out your service to reach pensionable age.

I think really that they are the major points that I wanted to draw out from the paper. We have identified some goals for our six major brands, an aspiration that we are trying to drive between 300 and 400 outlets. We have made it clear that to be a Mitchells & Butlers brand you have got to have either 100 units or an EBIT of more than 10 million and you have got to be making an acceptable return on investment. We will be working with the executive management in the very near term to develop plans which will either meet these criteria or they won't; and at that point we will make decisions on individual brands as to whether or not they will then have sufficient critical mass and consumer appeal to remain an M&B brand. We also are going to be doing some work to re-engineer the size and capital cost of some of our outlets to ensure they can trade on retail parks, leisure parks, and the High Street. Smaller footprint, less capital intensive, and with economics that will allow, the leasehold economics to work and still deliver a good rate of return will be a priority for us.

In terms of the planned withdrawal from non-core assets, we have identified a number of assets which we believe are not central to our long term strategy. We believe that the observations we have made are not new, that the conclusions we have reached were shared by previous management teams. We have, however, relaxed the criteria on divestments. We believe the business was unduly focused on avoiding earnings per share dilution; we will focus on net present value maximisation. What this means, scraping away the jargon, is that if somebody offers us more than an asset is worth and it is a non-core asset we will accept that price and will not be overly focused on avoiding earnings per share dilution; and this is just the application of common sense really.

Again, repeating my thanks to the colleagues confirming, as the paper does, that success for us will be to add 2-3% to operating margins from the fiscal '09 achievement over the next two or three years, I would like to throw the meeting open to questions.

Questions and Answers Participants

Tim Barrett
JP Morgan - Analyst

Jamie Rollo
Morgan Stanley – Analyst

Tim Ramskill
Credit Suisse - Analyst

Ben O'Toole
HSBC – Analyst

James Ainley
Citigroup – Analyst

Lena Thakkar
Merrill Lynch – Analyst

Richard Taylor
Liberum Capital – Analyst

Geof Collyer
Deutsche Bank – Analyst

Paul Hickman
KBC Peel Hunt – Analyst

Olek Keenan
JP Morgan – Credit Analyst

Hugh-Guy Lorriman
Seymour Pierce – Analyst

Questions and Answers

Operator

We will now begin the question and answer session. If you wish to ask a question please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request please press the # key. Your first question comes from Tim Barrett of JP Morgan.

Tim Barrett – *JP Morgan*

Morning, everyone. I had a couple of things, please, about the roll-out. Could you give us a bit more detail about how quickly you intend to roll-out the core brands and related to that, is it still your intention to spend £20 million on growth CAPEX in 2010. I think you said 40-60 million thereafter and then, one last thing, please. Can you talk about the brands that, in January, were described as 'maintain brands' and how those fit with the comments today about exiting the wet-led business? Thank you.

John Lovering

I think for the moment you shouldn't assume there's going to be a material change in the capital expenditure numbers you've been guiding to. We'll just be planning to achieve 15% more for the money spent. I think that will be across the board, we set ourselves the goal of being more productive by that level.

In terms of the smaller footprint, less capital intensive version of our key brands we're going to go into trial through this year with a view to testing some before the end of the calendar year. In terms of the maintain brands will be looking at each of the brands over the next few weeks and months to establish whether or not they can meet the minimum profit contribution and return on capital criteria that I've described and nothing is pre-ordained. If some of our smaller brands can demonstrate that they have that roll-out potential and have ability to earn the required return on capital, they stay. If they can't, we'll have to do something else with the property and the assets.

Tim Barrett – *JP Morgan*

I see, so even if they're wet-led by their nature but have a food component, it doesn't mean that they're necessarily no longer part of the business.

John Lovering

We've certainly endorsed the findings that Adam set out in January, but the underlying dynamic of wet-led pubs aimed at either very price conscious consumers or very young, circuit consumers: we completely agree that the fundamentals facing these businesses don't look attractive. We will be continuing this strategic drive from wet-led to food-led and, I think it's just going to be that little bit harder for the wet-led businesses to persuade us that they can achieve the level of returns over the medium-term that we're looking for.

There'll be no dogma, we'll basically…if we can make outstanding returns we are more interested in making money than being consistent.

Tim Barrett – *JP Morgan*

Great, thanks very much.

Operator

Your next question comes from Jamie Rollo of Morgan Stanley, please ask your question.

Jamie Rollo – *Morgan Stanley*

Thank you. Can I just clarify some of the questions Tim asked, please? On the additional 900 or so new pubs you're going to add. If you're sticking to the original…

John Lovering

I think that's a misunderstanding, go on. Carry on, finish your question [I'll pick it up].

Jamie Rollo – *Morgan Stanley*

It was really just on how long it takes to get there because if you're sticking to the original, well the January plan of £40m to £60 m of CAPEX of which, I think, £10 million was on conversions. That's about 20 to 30 new pubs a year even reflecting the slightly higher returns you're talking.

John Lovering

You keep talking about pubs. I want you to stop thinking about pubs and start thinking about licensed catering outlets. Therefore the presumption will have to come with freehold ownership is wrong. Secondly the numbers you've seen may not be new properties. The highest return on capital we make is converting existing houses into our more profitable brands, so there will be a considerable switching of assets and we'll accelerate that. Implicit in our approach to property is that all properties belong to the centre and not to the brand owner, and the centre will dictate, in partnership with the bidding line manager, who gets which concept. The idea that certain houses are aligned with certain brands is finished, they belong to us at the centre.

But the key point to make is that we will move as quickly as managerial capacity and opportunity dictates. We are not capital constrained. We certainly see that without committing ourselves to any timeframe, on exiting from non-core assets and from most extreme wet-led houses, our plan envisages recycling that capital into growth because the cornerstone of our thinking is that the securitisation is a very valuable asset to the Company. We won't do anything to compromise the assets underpinning it. We're going to have organic growth, recycling of assets and then a major recycling of money from some existing assets into new assets which won't necessarily be freehold and therefore we'll be able to get more units per pound of foregone sales than we would have done if we were simply buying freehold pubs.

Jamie Rollo – *Morgan Stanley*
My question was really to get to the additional 900 licensed catering outlets, even allowing for a somewhat different tenure mix, how many new outlets is that per annum? It still seems to be, going to be at least 10 years to get there and…

John Lovering
God no, I'm going to be old bones by then. Managerially we know we can do 100 conversions, the post Whitbread experience demonstrates we're not managerially constrained from going as fast as opportunity presents itself. The issue for us, is how quickly do we find acceptable offers which add to shareholder NPV from the non-core assets and that is actually the key determinant of our growth rate rather than, either managerial capacity or the balance sheet.

Jamie Rollo – *Morgan Stanley*

Thanks and then the second question. In the strategy on freeholds, where you'll sell if the returns are not above 11%; can I just clarify please, that 11% return on a cash capital or on the current book value, clearly a very big difference…

John Lovering
Neither: on the realisable value. If you look at the IRR earned consistently by property companies and by property, as an asset class, it makes 11% IRR which is the right risk adjusted rate of return for property assets. If we have assets that will make us more in terms of rental yield and capital growth than that, we keep them. If we believe that we would not make that kind of a return, then our shareholders should demand we recycle that cash into something else that will make this risk adjusted rate of return.

Jamie Rollo – *Morgan Stanley*
As part of the same question, what proportion of pubs or assets are not making that return at the moment in your assessment?

John Lovering
We haven't done the detailed assessment of 2,000 pubs, but what we do believe is that selling down property just for the sake of it makes no sense in that our respective costs of funds within the securitisation is about 4.6-4.7. A dogmatic approach that says that we sell property; if it means that we have to pay down any of the securitisations it doesn't make any sense. I wouldn't say our major thrust here is about divesting property. I was trying to make more of a cultural point that we see property as business and if it makes the right, rate of return it stays and if it doesn't it goes.

We do believe there are probably 10-15% of the current estate, whether freehold or leasehold, which will not fit easily with our new strategy.

Jamie Rollo – *Morgan Stanley*
Thanks, if I can just ask my final third question. On the internal tension, if we can call it that, not personal tension but the way the Company thinks about use of cash flow. Clearly, you want to increase the level of capital going into new catering outlets. You want to reduce the bank…

John Lovering

You can call them pubs really Rollo, I don't mind.

Jamie Rollo – *Morgan Stanley*

You can reduce the bank facility, clearly the pension payment might step up and, of course, you want to reinstate the dividend at some point. What takes priority in all of those and is the dividend policy still to resume once the bank debt is comfortably below £300 million, whatever comfortably might mean.

John Lovering

We made no real decision on dividend policy. I think, as with any public company, we have to have in mind that many of our shareholders want dividends and as soon as we think it's prudent to resume dividend payments, we will. I guess, if we can identify opportunities where we can invest shareholders money at 25% return on capital, then the first call on any resources we have must be do to that because that will add far more shareholder value than anything else that we could do.

Jeremy assures me that given our prospects in performance, refinancing that would not be a problem and negotiations with the pension trustees are at a very sensitive point. I don't really want to comment on that too much but I'm confident that we can balance the legitimate claims of all financial stakeholders in the business and still create growth and transformation for the business.

Jamie Rollo – *Morgan Stanley*

Thank you very much.

Operator

Your next question comes from Tim Ramskill of Credit Suisse, please ask your question.

Tim Ramskill – *Credit Suisse*

Thank you, I've got a few questions if that's okay. The first one was with regards to the move towards the focus on six different brands and the number of target outlets you're talking about. How many of those do you expect to be effectively sourced within the existing group as you convert some of the more drink-led outlets to those new formats? Second one and slightly related is what market research have you done to suggest that taking Harvester and Toby Carvery onto the High Street make sense. Forgive me but taking a Carvery brand to the High Street looks a little 1980s rather than a current-day so it just falls on how you get comfortable there. Finally, in terms of your comments in the statement this morning about reporting the returns on the property side of the business. Is that, in essence, you're just going to strip out what the internal rents have been and show us therefore, what those returns on those freehold assets are together with an annual revaluation i.e. the capital appreciation piece.

John Lovering

Well, we haven't thought about necessarily doing the annual revaluation but certainly, we believe, that the property business should show the assets that we own as the landlord and the returns we make both rent and disposal profit. The retail profit should be disclosed after charging that market rent. Clearly, whether it's annually or triannually or quinquenially, the shareholders are entitled to know not only the rental yield they made but the capital appreciation they enjoy by deciding to invest that much in property. We will find some means to communicate regularly to shareholders how their property business is doing.

Tim Ramskill – *Credit Suisse*

You won't necessarily lead to a different reporting structure *per se* we'll still effectively see...

John Lovering

It will, it certainly will internally and we want the property function to be a business not a support function. In terms of the report and accounts, we will…this is real new thinking. Chartwell Land and Sears did this in 1986. We will show shareholders the segmental analysis of the business between profit and assets deployed in retailing and in property ownership as a supplement to the key financial statements. What was your second one…market research?

Tim Ramskill – *Credit Suisse*

Well, sorry, well…

John Lovering

I think the point is well-made. The great beauty about retail businesses is that you have the luxury of trialling. What we do know is that there's huge consumer demand for a number of our brands and we are very confident that they will work on leisure parks, because we've seen one of our competitors demonstrate that it can be done. We have something over 20 Harvesters already on leisure parks, so we'll move incrementally but we will, first of all, we'll move into leisure parks, we'll then do market research, refine the product and try a few retail parks. Then, if we're really brave, we'll get out there and try and mix it on the High Street but everything we do will be based on the three maximums of test, measure and act. We won't act until we've done those and we'll certainly trial and refine but this is not…I'm not a great conviction executive or Chairman. We will test, refine, and if we have to go back and recycle, concepts or menus we'll do that.

Tim Ramskill – *Credit Suisse*

My final question which I asked is about how many of the 900 or 1000 or so sites for those six brands, how much of the gap is going to plugged by, effectively, utilising the existing estate?

John Lovering

Look I've been working hard for 55 days but I've been getting a bit of sleep and so has Adam. The answer, we have a pretty detailed site-by-site property plan which will be increasingly clear on the redeployment of our existing estate, but I wouldn't want to go firm on a number. The obvious thing to say is that when, clearly, redeploying our existing assets delivers a higher return to us than going out into a completely new site but we'll be opportunistic. If we see higher return opportunities outside our estate, we'll make them the priority but clearly I think the way I'd answer it in a different way and say that somewhere between 10 and 15% of our estate is unlikely to be consistent with our plan.

Tim Ramskill – *Credit Suisse*

I was going to say, could I summarise then. If look at the 900-1000 sites for the six brands, that's roughly the size of the existing business, so 10 or 15% of the site exit you need to replace with 10 or 15% more to maintain that overall size of the Group.

John Lovering

Exactly.

Tim Ramskill – *Credit Suisse*

Thanks. Thank you very much.

John Lovering

Don’t assume they’re freehold, necessarily.

Tim Ramskill – *Credit Suisse*

No, sure.

John Lovering

In fact, quite the opposite.

Operator

Your next question comes from Ben O’Toole of HSBC, please ask your question.

Ben O’Toole - *HSBC*

Yes, good morning. I suppose, following up from Tim’s question it’s really with regard to the leasehold sites, are you willing to outline what your hurdle rates would be on the leasehold assets as opposed to the…

John Lovering

Yes, that’s in the paper. We’re looking, like any retailer, we’re looking to make a 25%, four-year pay back on a leased asset. As any other High Street retailer would do…

Ben O’Toole - *HSBC*

Fair enough, and have those, actually, been identified then? The potential new units when your talk about leisure parks and retail parks, have you actually identified.

John Lovering

No, I'll assume that is a question you're asking to ask rather than to expect a sensible answer. Clearly, we don't have the 3 or 4 year plan roll-out for leased units.

You can look up on the web where retail parks are and you can probably get yellow pages to discover where High Streets are, but in terms of the specific sites, we'll only have this year's current planned CAPEX lined up and signed up. It takes 2 to 3 months to sign up any leases.

Ben O'Toole - *HSBC*

Sure, I understand. Then, one final one, is it sensible to assume that you might actually look to dispose of individual brands that are deemed non-core?

John Lovering

Sure, absolutely it is. We will look at it purely financially. If we are offered more than the present value of an asset that we think is not going to achieve our criteria, we're indifferent to whether we sell the brand with the houses or we sell the houses or we redeploy the houses. We'll do whatever brings in the maximum net present value for shareholders. If somebody wants to buy one of our brands and has a different point of view on its growth potential or they're scale aspirations we'll, of course, take their money if it's enough.

Ben O'Toole - *HSBC*

So one final one. With regards to the adding 2 to 3% points to the net operating margins over the next 3 years, presumably that's excluding any conversions to leasehold businesses where there would be a higher rent charge, is that…

John Lovering

I think that's a fair comment. We are talking on the margin effect of trading rather than property ownership or financing.

Ben O'Toole - *HSBC*

Thanks very much.

Operator

Your next question comes from James Ainley of Citi, please ask your question.

James Ainley - *Citigroup*

Yes, good morning. I have two questions, please. Firstly, when you talked about the 10-15% of the estate that doesn't fit easily with the new strategy and therefore likely to be disposed of - that implies about 30-45 million of EBIT assuming a 10 time multiple or a 10% return on those assets, £300-450 million of potential capital that you could raise and then redeploy. Just to be clear on that, are we saying that that capital if redeployed would generate a 15% return on capital if it was deployed…

John Lovering

It better do more than that or I get fired.

James Ainley - *Citigroup*

You talked about a 15% return on property improvements and conversions and then a 25% return on…

John Lovering

Leasehold, yes. So I would say if you took a blended view that we were going to try and make 20%, although I don't want blended returns. As you see one of the keys is to separate the two businesses, but I know you need to do some numbers. I think if you applied a 20% blended return to the money we redeploy, you won't be far out.

James Ainley - *Citigroup*

Is it reasonable to assume a five year timescale to exit those 10-15% and redeploy?

John Lovering

Well again, you will have to make whatever assumptions you can. Clearly we are strongly motivated to make the transformation as quickly as we can, because time costs money and money is shareholder value. We will be opportunistic and we will be trying to do it faster than that, but in terms of producing your projections I don't think anybody could argue against that. I suggest put forward we will be striving to move considerably faster.

James Ainley - *Citigroup*

But there is an incremental 40 million of EBIT there from that exercise is what you're saying. The second question I had was on the gross margin erosion of circa 30 million in the last three years. Can you give me a better sense of how you seek to recover that. You mentioned from supplies and pricing, but I mean is pricing realistic.

John Lovering

I am bored with my voice, Adam why don't you dive in and answer that one.

Adam Fowle

It comes in two areas, one is we're going to use the term 'spends' rather than price, because this is not just crudely putting the price lever, it is marching customers back up the menu to spend a little more per head. That could be trading up dishes or it could be trading up a number of courses. Either way, it works for us both ways. The other one is we have had quite a lot of success in the last six months from the way we have reorganised food buying and menu development. We expect to see that success continue. So it comes at both ends from cost of goods on the plate, but also encouraging customers to spend more.

Operator

Lena Thacker, Merrill Lynch.

Lena Thakkar – *Merrill Lynch*

Hi there, just regarding the non-core assets, I know you have spoken about the 10-15% of the estate. I was wondering if you could give us some more colour on potential disposals of things

such as Alex and the Hollywood Bowl. If you were able to sell everything that you could what sort of disposal proceeds would you perhaps get on those and the EBITDA that would be lost?

John Lovering
Well we're obviously trying to get a pound more than they are worth. In terms of the specific numbers of EBITD that we would be foregoing or the proceeds that we would be getting in, if I were to be involved in any discussions on divestments I couldn't reveal to you what I would accept. I am going to jump the question, but say that the previous little bit of calculation that one of your colleagues did on how much free capital we're hoping to release to redeploy, isn't far away.

Lena Thakkar – *Merrill Lynch*
Then just on the net debt to EBITDA target of five times. Is there a timeframe for that? On my numbers you will probably get there within a couple of years anyway. Or would you rather be at that level next year? I am just wondering why five times? Why do you feel comfortable with that level?

John Lovering
I am going to get the Finance Director who recommended it to me to tell you.

Jeremy Townsend
We're making very good progress towards five times. At five times I think we're at a level of debt which is totally appropriate for the business. We have got plenty of free cash flow, we can fund organic growth and we see sufficient headroom on the fixed charge cover and interest costs. We were at 6.1 times at the beginning of the year. We will make good progress towards five during this year, and as you say, we would expect it five times during FY11. What we're saying is at that level there is no need for further debt repayment; that is the key message.

Operator
Richard Taylor, Liberum Capital.

Richard Taylor – *Liberum Capital*

Morning guys, just a couple of questions please. Firstly, could you give us an idea of the six brands that you're looking to expand, what the returns are currently and how they stack up on an EBIT per site? I think you implied that over 100,000 a site qualify. Secondly, just can you give us the definitions of the returns? I know you say it is cash on capital. Is that an EBITDA pre-tax or post-tax? Finally on the margins, I know you have touched on how you hope to achieve margin improvements. I think when questioned a couple of months ago as to whether you could achieve peak margins again, Adam's answer was something along the lines of there was a pricing bubble a few years ago, there is no chance of us achieving that. Can you tell us what has changed in your mind in the last two months as to why you can achieve 2-300 BPS of margin improvement?

John Lovering

Let me start with the last one because if you add up the numbers, we're going to reduce our overhead costs from 4.3-3.75. We're going to take £10 million out of the goods-not-for-resale and the supply chain, and we are going to be taking the price action and more importantly the promotional and menu redesign and food sourcing actions that Adam has outlined. The business has – and I am not being at all critical of past decisions, they may well have been right – the business has made very large volume gains and very large market share gains. The business is now in the fortunate position of being able to optimise its operation a little. I am confident that we can achieve the kind of improvements that have been identified.

Clearly over the next 12-18 months we have had to a take a view on government policy and the state of the UK consumer. Any long term projections you're making, when you advise your clients, you will be making some kind of assumptions on the way you see the economy. Similarly, any statements we have made looking forward are very much conditioned by the wider macros. But I think looking at the business, we have not put those proposals forward lightly and we are confident of delivering them. That was your first question, what was your second one; how do we measure returns?

We think cash-on-cash. I think one of the things that a lot of businesses have done over the years is they have made investment appraisal and decision making quite complicated and they have a number of different acronyms of how they're measuring returns. We look on returns dead simply which is cash-in over cash-out.

Richard Taylor – *Liberum Capital*

For clarity; that is pre-tax?

John Lovering

That is EBITDA as you said cash profit over cash outflow.

Jeremy Townsend

That is pre-tax EBITDA.

Richard Taylor – *Liberum Capital*

The first question was about your six growth brands, how they measure on the returns measures and also the EBIT per site.

John Lovering

I am not going to answer anything on branch performance or branch profitability. Good analysts work out what they don't know from what they do, they don't always get told the answer.

Operator

Geof Collyer , Deutsche Bank.

Geof Collyer – *Deutsche Bank*

Morning guys. I always seem to press the button first and go last, so apologies for that. I have got a couple of questions. One, just to clarify the 10 million profit per brand or format is after rent or before rent. I presume it is before rent, given your comments. Secondly I presume going back to Adam's presentation in January that the 300 out of the 450 sites that aren't suitable for conversion upstream that is the rough number of sites as opposed to the cash cost that might disappear. Thirdly it is a philosophical one; if you look at the split that you have historically given as a business in terms of pubs and bars and restaurants , and I know you have now got a new three-way split rather than a two-way split, but we haven't got the profitability yet. The profitability on the pubs and bars i.e. the wet-led business has generally been 250-odd basis points higher than the food led business. If you're going to move much more down the leasehold route and down the food route, is that not going to make it that much more difficult to achieve your 200-300

basis point movement on your margin. Or put it another way, if you're talking about that 200-300 basis point movement on a pre-rent basis, is not possible that that all gets eroded by the rent costs going to the P&L at the actual EBITDA line?

John Lovering
We certainly hope not, otherwise we wouldn't be doing it. Let's pick up your points. Clearly in terms of…the answer to your first questions, I just wrote down yes and yes. I can't actually remember what they were but I think I agree with both.

In terms of does the switch from wet-led to food-led dilute returns? The answer is in the very short term it may do in certain situations. However what we have done is we have projected forward the performance of wet-led pubs and we have projected forward the performance of food-led outlets. We're convinced that in terms of maximising the medium term value of this company, that is the right decision. If at the margin we have to pay a little bit more for a high growth asset and get a little less for low growth asset that must make financial and economic sense.

In terms of can we sustain performance in the face of the switch you said; it is Adam's view that we can hold labour costs at a constant percentage of turnover despite the shift in product mix. That is crucial in looking at the profitability going forward. We believe we can do that. It is highly significant because as you will know from our accounts; labour is about 20% of our sales, so it is a massive component for us. There, the combination of retaining our colleagues for longer in the business so they become more productive by reshaping the way we schedule hours and the way we communicate scheduling to them is crucial. Secondly, we're going to renew and revitalise our in-pub IT systems to make sure we have got even greater control of labour and wastage costs. You're absolutely right; strategically and directionally in the short term it would have the effect that you have laid out, but we believe that we can overcome those. Secondly of course, if we can grow the business faster than the central overhead is growing or the infrastructure costs are growing, we will get an improvement on margin. That is why a lot of the concern that we were going to contract the business is nonsense, because we must grow the business to get even greater economies and get even more contribution per pound of fixed costs than we're getting at the moment and that will have the effect of improving margins.

Geof Collyer – *Deutsche Bank*

To be honest, I was slightly less concerned about the returns. It was more the structural issue on margins given that…

John Lovering
You are right.

Geof Collyer – *Deutsche Bank*
But the point is as a group you have been significantly successful in moving the cash margin within the restaurant business as opposed to the pubs and bars business. I just wondered why you were more fixated about the operating margin rather than the cash margin.

John Lovering
We're not. If that has come across; that is a mistake. What we have put into the release which must be true and it has certainly been true in most businesses, certainly in Debenhams. We're much more interested in cash margin per outlet or pub than we are in a percentage *per se.* We want to grow cash margin faster than the growth in fixed costs, because that is how you increase profits and value to shareholders. It is just that you are communicating the goal for real cash margin per pub, we found that really difficult to put into words. We have shorthanded it to a margin improvement. The philosophy of the business will continue to be: we want to maximise cash margin per unit and we want to maximise cash margin for our total business in real terms.

Operator
Paul Hickman, KBC Peel Hunt.

Paul Hickman – *KBC Peel Hunt*
I have got two questions. Firstly on the central and operating overhead reduction. Just if you could explain; do you expect this further reduction to correspond with any decrease in functional support? As part of that; how much of it, I suppose that part of it is in enabled by the implicit simplification of the brand structure? The second question was bearing in mind what you said…

John Lovering

The first one the answer is no and yes. In other words, your second point is right, that a component of the overhead reduction to 3.75% is because of business simplification. In terms of functional support, no we want each of our businesses to continue to receive the very best marketing, productivity, estates, finance, support that it can get. We do believe like all big corporations, probably like all big financial institutions, that we can challenge some activity, some bits of paper, some committees, some processes, in that there is no business alive that you can't challenge and take cost out of the central costs, simply because that is just the way it is. I would say compared with some of my recent experiences the goal we have set is comparatively modest and is defined to ensure above all that we do nothing to reduce the quality of the service and control in the business.

Paul Hickman – *KBC Peel Hunt*

Thank you very much. The second question was about internal rent disciplines. Bearing in mind what you were saying about the philosophy of who controls the property. Are you expecting this to be an internal accounting exercise? Do you actually intend to move the property into a separate legal entity?

John Lovering

There is no real need to move the properties; all it does is creates fees for lawyers. We want the internal and external measurement and reward system to achieve our goals. I think that, the other reason we don't want to anything to do the legal structure is everyone will be assuming it is a forerunner to something more radical. We can see no need or justification to anything more radical provided we explain clearly to our shareholders the businesses they own and the performance of those businesses. We don't need to do anything more dramatic. Similarly, I don't think we need to leave them into any entity to get the managerial behaviour we want.

Operator

Olek Keenan, JP Morgan.

Olek Keenan – *JP Morgan*

I have got two questions. One is about a specific comment in the release. It says that you have the flexibility within the securitisation to extract non-core assets and inject a certain amount of operating leasehold income.

Jeremy Townsend

We have got the opportunity; within the securitisation we can hold a certain number of leasehold assets and part of our thinking is to just rebalance the mixture of assets within securitisation and outside of it so that we can increase the leasehold mix within the securitisation. It was just demonstrating the fact that we have the flexibility within the business to increase the leasehold mix in line with the overall strategic direction.

Olek Keenan – *JP Morgan*

Do you know how much of an increase, because it is very close to zero for now?

Jeremy Townsend

We can put up to 400 pubs in the securitisation.

Olek Keenan – *JP Morgan*

Four hundred pubs, okay great, and then secondly, just to make sure I understand the numbers for the estate. The 913 in what's now the core brands and of the remaining 900 you see 2-300 as being possible sale candidates. Presumably the 2-300 you buy to replace that would all be into the core brand, so that leaves 600, which would either be converted, or those brands would become part of the core group.

John Lovering

Well put, that's exactly right, yes.

Olek Keenan – *JP Morgan*

Yes, it's that number. Great, thank you.

Operator

Once again, if you wish to ask a question please press *1 on your telephone and wait for your name to announced. Your next question comes from Hugh-Guy Lorriman of Seymour Pierce, please ask your question.

Hugh-Guy Lorriman – *Seymour Pierce*

Yes, good morning Chairman and team. I thought this was a very comprehensive review statement and very impressive. I have a few questions, if I could go one at a time that seems to be what suits you. The first one is on the rent levels, following on from some of the other questions of my colleagues. Who and how will decide this? Will you do this on an internal basis, do you have a property team who will look at this and based on yields and so on or is it external; that's my first question.

John Lovering

We will use the internal team to set our rents where they are on our current freehold and, clearly, we will use a mixture of 'evidence' where there is evidence or we'll have a rule of thumb which relates the rental payment to the historical performance and capital expenditure committed to the house. The key point is that if we upgrade the non-retailing part of the house then we will be able to reflect that in rent. The retailers will basically pay for the correct cost of investment made on the property they're occupying.

Hugh-Guy Lorriman – *Seymour Pierce*

That's great.

John Lovering

We will use that internally because somebody was supposed to ask me the question, "How much we spent on the review?" and I was going to say, "Nothing." The message we want to get across is if we can do it ourselves and not spend any money we'll do that rather than enrich our friends in the advisory industry.

Hugh-Guy Lorriman – *Seymour Pierce*

Yes, great. My second question is on the margin, you closed your speech just now with saying success will be 2-3% operating margins and I think that's very impressive, I like that. My sense is

that you're saying, "We're really going to go for it as early as possible and therefore we should be seeing some of that even in the current year." I thought of 2-3%, let's say a half a percent in the current year might be achievable which, in terms of the total revenue is at around 2 billion, looks like 10 million to add which hasn't been expected prior to today. Is that about right, in total profit.

John Lovering
I'm not going to comment on forecasts and we wouldn't presume to tell you how to affect your estimates. At the moment our position is, we're broadly happy with consensus and we will leave any discussion of short-term trading and short-term prospects to our interims which, Jeremy, I think are what, the middle of May?

Jeremy Townsend
Middle of May, that's right, John.

John Lovering
Yes, so we speak today very much about the strategic direction of the business, not refining the forecast.

Hugh-Guy Lorriman – *Seymour Pierce*
Fair enough and then the…what I did find looking through the statement is there did seem to be a fair amount of things which felt like changes to management. There's a thing about senior management compensation schemes and later on reviewing all our management resources, hiring new persons and the statement you made about pensions. It feels to me there's still a sense of quite serious change in management through the organisation. Could you make a comment on that?

John Lovering
I think, factually, what you say is true. I don't know about throughout the organisation but it is a fact that Jeremy's decided to go off and be a rat-catcher that one or two other senior members of the team have decided it's time to look elsewhere and we wish them every success.

Hugh-Guy Lorriman – *Seymour Pierce*

Could you give me any details?

John Lovering

No, [I think management]…

Hugh-Guy Lorriman – *Seymour Pierce*

Can you give any detail on other senior members does that effect, for example, the three, City …

John Lovering

Line management are firmly in place and committed. I think it's reasonably well-known. I think we've announced that Chris, our HR Director is moving back into academia and decided, it pre-dates me, we have a new commercial director joining us with a very strong emphasis on purchasing. I think that is in part just the ebb and flow of people throughout the organisation. I think more fundamentally the point we make is, I do believe and I certainly don't apologise for it, I think there are two key themes we're making; 1) we want to make this an incentive culture where to use a cliché that I use many times in private equity deals that: He who works well eats well and he who works the best eats the best. That will be the philosophy and culture running through our business. We believe in incentives, we believe in direct linkages and performance to benefit. We do believe that the business has immense strength in its experienced senior operating management but, I do believe, we must avoid, without being disrespectful to M&S in the '90s, we must avoid an M&S culture where we don't have any new blood coming to the business at middle and senior middle levels. I want to bring some people into as yet unspecified roles in the business from mainstream retailing or mainstream high-street catering. Not because I think there are any failings in our current team but, I think, philosophically that injecting new blood and new views and new challenges into an organisation is critical.

Hugh-Guy Lorriman – *Seymour Pierce*

Would you say that in terms of the senior team the guys that, we the analysts, have seen, the heads of the three the suburban, value, city and country and the head of the executive team. We won't be seeing changes there in the next few months?

John Lovering

It depends if they get a better offer, you better ask them because nobody's indentured in our company and if Debenhams want to hire them as Chief Executive then, I guess, they'd have to make their own decisions but, certainly, I have seen nothing to suggest to me that they're not highly productive super committed professionals that this company has valued and will continue to value.

Hugh-Guy Lorriman – *Seymour Pierce*

Excellent and then my last point; my last question is that I saw, flashing over my screen, a report from the Guardian saying that they…

John Lovering

Sorry, you don't read the Guardian?

Hugh-Guy Lorriman – *Seymour Pierce*

Well I don't, but I saw it flash it up…Saying that there will be material pay rises for non-executives. Now, I'm not meaning to be impertinent but if you can relate that, deny it or relate it or whatever but to the whole culture that you talked about today of bringing margins up, increasing margin and the changes in management and the new culture. Can you talk about that?

John Lovering

Yes, no I'm very happy to comment on it. I will be earning 350K a year but I'll take it all in shares. My deal won't be as rich as Archie's if that means anything at this point but seriously, in terms of the non-executive payments I have absolutely no problem defending that we have assembled a top-notch group of non-execs who, over the last 8 weeks, have almost been working full-time on the Company's business. Without being rude to anybody in any company, I think it's no coincidence that…what I really want to say is, I think, there's a wider issue that if we want good governance and good value added in the boardroom we can't expect people to do that for love and basically anybody that the old regime could afford and motivated to work for, we had to challenge whether they were giving enough time or enough quality to the cause. I'm very happy to defend our policy on boardroom pay and if any director, executive, non-executive or chairman, is not adding value substantially in excess of their cost we'll get shot of them.

Hugh-Guy Lorriman – *Seymour Pierce*
Right and I suppose my last point would be, could I have a word from Adam, more on the emotive side of how it's been for the last few weeks and the feeling in the business at his level and with the changes and this new strategy.

Adam Fowles
Hugh, yes it's Adam. The emotional side of the business, I think, we're just getting on with running the business. We see this as less of a new strategy and more of a acceleration, going harder and faster at steps that we initially set out back in the end of January. I think, within the business, the business wants to get on and focus on the future and it will be pleased to have clarity around direction and objectives. I think it's a very good thing and I think there's a sense that we've reached another milestone and it's a good one, and we're looking forward to the future.

Hugh-Guy Lorriman – *Seymour Pierce*
Thanks very much for that.

John Lovering
No problem.

Operator
Once again, if you wish to ask a question please press *1 on your telephone. As a final reminder if you wish to ask a question, please press *1. Your next question come from Jamie Rollo of Morgan Stanley, please ask your question.

Jamie Rollo – *Morgan Stanley*
Thanks. Sorry. We're probably running out of time but just two really quick ones. First you mentioned licensing brands to other operators of licensed catering outlets. Are you in discussions with anyone there; could that be material?

John Lovering

No, I mean we're not. All we were thinking was that at various times in the past there have been thoughts that our brands could add value to other people's properties and we're not ruling it out but, I think, in terms of our main strategic thrust, and your forecasting for the business, I wouldn't factor too much in. I think we were just trying to demonstrate that, as well as owning assets and leasing assets, there were other ways that we could put our brands into wider distribution. Adam, I don't know if you want to add or…

Adam Fowle
John, I think, that's absolutely right. It is worth noting that we do license two O'Neills, to the restaurant group in airports and we've done that for a number of years. We were just raising the fact that we don't have an ideological problem at all with other people as it were using their property to make the most of our brands for us.

Jamie Rollo – *Morgan Stanley*
I'm not sure I dare ask this one but it's probably fair to say that there's been some disagreement, maybe friction you can call it, between some of the institutional shareholders and some of the private shareholders. You might not want to answer this one, but is that institutional mistrust – for want of a better word – or misunderstanding. Is that well-founded in your view and do you think that the new board and this review is enough to correct any of that mistrust or misunderstanding?

John Lovering
I hope that you and the other people on the call's evaluation of what you heard will be formative in answering your own question. Clearly, we have done what we'd said we'd do which is to draw a black line under the Company's history pre-29 Jan or whenever the AGM was. To date I'm not aware of any difficulties or constraints on the way we sought to manage the business in the last two months reflecting our shareholder base.

All we can do as management, I sound a bit like a football manager at Liverpool or Portsmouth here, but all we can do is manage the business to the best of our ability to deliver value to all the shareholders. We hope that all the shareholders will find it a convincing and compelling plan and be content to give us support but in terms of any negatives, since I've been in the Chair, I'm pleased to say that we're successfully mimicking a normal public company.

Jamie Rollo – *Morgan Stanley*

That's very clear, thank you.

John Lovering

Simon, are you on the call still? No, I thought Simon was going to join us because as Senior NED, he might have had a comment on that but he's left us.

Operator

You have no further questions at this time, please go ahead.

John Lovering

Well, thanks very much for your interest and support. I look forward to seeing what you make of it but thanks for your support and interest and we appreciate it. Thank you. I'll close the conference. Thank you.