23 September 2010

Mitchells & Butlers plc

Final Results 2010

Corporate Participants

Adam Fowle

Mitchells & Butlers – Chief Executive Officer

Tim Jones

Mitchells & Butlers – Finance Director

Questions and Answers

Question 1
James Ainley, Citi

Good morning it's James Ainley from Citi. Two questions please. Can you talk about the current like-for-like performance and say how much of that is driven by price, if any?

And secondly, can you talk about, specifically about food cost inflation, what you expect to see in FY11 and the percentage of contracts where you are fixed and therefore have cost certainty on food? Thank you.

Answer – Adam Fowle
There is very little price in the existing like-for-likes, it continues to be spend. There is a bit of price and a bit of volume. So it is pretty much on the same run rate as it was before, the balance of those.

In terms of cost inflation. I mean the outlook is quite benign. There are some commodities going up, some going down. I think we are pretty comfortable with saying one way or another we can keep that very low during the year, very low.

If you are going to ask me where we bought forward, all the big commodities, there is a degree of price certainty through Easter I guess.

Question 2
Jamie Rollo, Morgan Stanley

Thanks, Jamie Rollo from Morgan Stanley. First of all just on the pipeline. You have got 50 new sites for this year, I think half are Ha Ha. What sort of unit growth should we expect for 2012 onwards? Are you confident there is enough out there on a sort of selective basis to do at least 50 for next year?

Secondly, in terms of looking at your market outperformance in the drinks sector. Clearly you are less exposed to that segment now. But what is the market share gain on drinks? You seemed to have been a little bit sort of greedy on price with a bit of a volume slippage during the last 12 months if I may say so.

And the third question really is perhaps an observation, but also a question. You have delivered 14.5% profit growth in the Retained Estate in the year with about 3% like-for-likes. Consensus forecasts for this year are about 5% profit growth. Obviously your like-for-likes are doing better so far. And the cost outlook seems to be similar to what it was in 2010. Isn't consensus just too low for 2011?

Answer - Adam Fowle
I'll let Tim answer the last one. I will give him a chance to work out the answer. On the new builds for next year. We are clearly pleased to go from a standing start of 1 last year to 50 this year. I think we would expect to be able to do at least that in 2012/13. And we will be hoping to do more than that. I am not going to put a figure on that right now, but we would expect to do at least that. There are tons of opportunities out there. And one of the things about this expansion is that we have got 13 brands or fascias, all of which are playing pretty strongly at the moment and each of them requires a slightly different property. So we're not hunting down a single property type. We can spread our activity across it.

In terms of drinks volume outperformance. I think the drinks market was down 6-7% last year. Our volume will be down about 3%, I am looking at Adam about that. So we will still be taking drinks market share on the Retained Estate.

Further answer – Tim Jones
On the consensus Jamie, I mean the number we've got as of last night for FY11 is an operating profit of about 295 and an EPS of 27.4p. Based on what I've seen this morning I would expect that to rise up to 300-305, something like that.

Further question - Jamie Rollo
That will certainly imply a fairly modest growth. Can you do 14-15% EBIT growth again this year? I mean not giving a forecast, but are there any external factors suggesting you couldn't do that again?

Answer – Adam Fowle
Part of the growth this year was the EBITDA margin growth on Retained Estate which was 1.9% and we won't be able to repeat that next year. We will get some margin growth, but not almost 2 points.

Jamie Rollo
Thank you very much.

Question 3
Geof Collyer, Deutsche Bank

Yeah. Hi Geof Collyer from Deutsche. Just on the property internal rent that you have set. If you take the internal rent plus what you are already paying, it looks like, maybe on my forecast which might be a little bit low for next year, you are charging somewhere between 12 and 13% of sales in terms of rent or you are looking at that as a ratio. That seems quite aggressive compared with what the other pure Opco's in the sector might be paying. Is that indicative of the sort of price you are having to pay for your own rented sites or do you think that is a pretty fair result?

Answer – Tim Jones
If anything, we think it is reasonably benign actually. We have looked at it as a percentage of EBITDA and not sales and we have taken 40% of EBITDA. I think a number of metrics we looked at there raised above that. They may be a result of legacy setting and rent and EBITDA has come down. But I don't think 40% of EBITDA is a high level, no.

Question 4
Paul Hickman, KBC Peel Hunt Limited

Thanks, Paul Hickman from Peel Hunt. Just looking at the Retained Estate margin growth, an impressive number of 1.9%. Could you comment on how that varied between the first and second half?

And also I wondered if you could just tell us what were those £6 million of non recurring items that you mentioned at the start?

Answer – Adam Fowle
I'll answer the first question. It was higher in the first half than it was in the second half because obviously if you go back to the first half of 2008 that was when the recession really hit and the margin was down a lot. So it was quite a bit higher and the rate of growth was higher in the first half.

Further answer – Tim Jones
Yeah the non recurring items really relate to primarily lease contracts that we are tied into where we either have a vacant property that we are contracted to pay a lease rate for or we have a sub tenant and we are making a loss on that sort of pass through. So we have quite rightly taken the view that we need to forward provide for that. So it is not cash at the moment, but it represents a commitment that is unavoidable until we manage to avoid it. So we made a proper provision against that. So as I say, it's not cash and it's a sort of one off.

Question 5
James Wheatcroft, RBS

Good morning, a follow-up to Jamie's question in terms of new openings. Could you give us a view in terms of what you think the leasehold proportion of the new sites is likely to be?

Secondly, within that, would you consider airport retailing? And also in terms of disposals, perhaps you could give us an update as to whether that is now complete or things like SCPD and Alex what, where are they in your views?

Answer – Adam Fowle
Right, in terms of the leasehold mix it will be much higher than it has been historically. The Estate is now I think 90% freehold. So there is room for us to take more leaseholds on. If you look at the 50 going forward this year, I think the number will probably be 65% leasehold, something like that. But again it depends how the opportunities arise. If pubs come up, obviously they tend to be freehold, not leasehold.

Airports, yeah. I mean our strategy is to put our brands where the customers want them. And if that means travel hubs and airports, then over time that is where we should be. We don't have an ideological objection to it any more.

And in terms of disposals, I mean disposals are never over, but the big lumps are. We have still got the leased or the franchised estate to go. And I think that is well flagged what is going on there. So that should leave us at some point.

In terms of SCPD and Alex they are small parts of the business. We have reviewed our options with them over the past and is never immediately apparent what the right value creative route out is. So they are where they are at the moment. I think it is fair to say that Alex, the German business, has turned a significant corner over the last 18 months and is performing quite strongly now.

Question 6
Tim Barrett, JP Morgan, Cazenove

Morning. Tim Barrett, JP Morgan, Cazenove. Two quick things. Firstly, it feels like you have achieved the 17% margin faster than most of us were expecting on the Retained Estate. Can you say what is still ongoing in terms of cost saving initiatives, non beer supply chain, those kind of things, for next year?

Then the second thing is just an observation, you said 7.7 times EBITDA on the carrying value in the balance sheet now. That feels very low relative to what you sold the non core business for, for a completely different quality asset. How should we think about that carrying value please?

Answer – Adam Fowle
I will let Tim answer that in a moment. If I just deal with the costs. I mean we have a programme going forward a number of years looking at what I would call the big structural cost lumps in the business. So the non food supply chain was done last year. This year we are looking at the non drinks supply chain and we expect that to produce some benefits this year. And looking past that, we have got a lot of work to do on our central IT costs and things like that. So we expect to be able to keep nudging the margin up through those sorts of activities.

Further answer – Tim Jones
And on the property, you are right, it is low, it is a prudent or conservative valuation deliberately so where we haven't found market evidence to allow us to put a full value on assets such as with the larger pubs, we have stepped away from that and taken a discount, just so that we have a solid and conservative balance sheet. It is in no way meant to be a market value of those pubs. It is an accounting prudent value.

Question 7
Hugh-Guy Lorriman, Seymour Pierce

Morning, Hugh-Guy Lorriman from Seymour Pierce. Could you talk a little bit about central costs? It was just mentioned there in response to Tim's question. In questions in January you said they were about 4% of the FY09 revenues which was about £80 million. Where have they gone to in the last year in FY10 and where are you looking at guiding or how are you looking at it going forward?

Answer - Adam Fowle
So broadly flat in the year. Next year it is a little bit of an anomaly because we are providing a transitional services agreement for Stonegate for a period of a year. But our aim is to get it somewhere around the 4% mark, maybe slightly above that next year.

Further question
One more question, on slide 28, you look at food sales market outperformance. You have used Crest data, NPD Group at the bottom. I understand you are also part of the Coffer Peach Business tracker which has been showing quite a lot of positive growth in the last few months. Could you talk about why you have used this particular metric and how you perform compared to the Coffer Peach tracker?

Answer – Adam Fowle
We actually track three metrics. This, ONS and Coffer Peach. I think it is fair to say in order of accuracy, it goes ONS, This and Coffer Peach which only works for as it were the branded chains in the market. In all cases we show market outperformance. Clearly less market outperformance against the branded chains and much more market outperformance against the Solus operators.

Question 8
Julian Easthope, Barclays Capital

Thanks very much, it's Julian Easthope from Barclays Capital. Three questions if I may. First of all in terms of your current infrastructure, you are building 50 new units this year. How many sites do you think your infrastructure could actually withstand in terms of building units?

The second question is on the securitisation. I think by the time all the disposals go through, there is around £69 million of lost EBITDA or sold EBITDA. I presume most of that is in the securitisation. Will you completely replace all that so that your covenants within the securitisation will be identical moving forward or the head room to the covenants?

And lastly in terms of the dividend. If most of your new leased properties that you are building are going to be leasehold properties, probably cost about £800,000 a piece, you should have plenty of cash left over. Why did you feel so conservative and prudent with regards to the dividend? And in particular, I will leave it at that actually, thanks.

Answer – Adam Fowle
So I am going to pass the last two onto Tim in a minute, but let me talk about our infrastructure. We will be doing 70 conversions and 50 new builds this year which is 120 new branded outlets. At the peak of the Whitbread conversion programme in 2006 we did 180. So I think our capacity is somewhere around I guess the 150 mark. That is my guess. 100 would be, I wouldn't say comfortable, but quite runnable for us. Securitisation?

Further answer – Tim Jones
Securitisation is quite prescribed over the valuation of assets that you are transferring into securitisation in order to extract the cash. So it is not necessarily 69 EBITDA comes out, 69 has to go in. We have a valuation metric. But we will of course be putting in sufficient assets to make sure we have comfortable headroom against all of the covenants and restricted payment tests that we have within securitisation. And we have those assets and we just need to effect that transfer and I would expect us to do it by the end of the year.

Further answer – John Lovering
I will cover the dividend point. I think we agreed on analysis that the business looks as though it is and will be strongly cash positive and we anticipate free cashflow going forward. I think the Board would be distinctly aware that when we review it next they must be both significant and progressive. And there is a clear over conservatism in the Board to make sure that M&B, after a track record of one or two corporate decisions which with hindsight we might have reviewed, perhaps have to be excessively conservative to make sure that when we make that decision, it is absolutely soundly rooted, and there will be absolutely no issues of our dividend policy being consistently and progressively applied going forward, but absolutely right.

Question 9
Lena Thakkar, Bank of America, Merrill Lynch

Hi there, Lena Thakkar from Bank of America, Merrill Lynch. Firstly if I could go back to the property impairment, you spoke about the discount taken to the high end pubs given the lack of transactions, but I am just wondering what the methodology for that was and why 4%? What was that based on exactly?

Answer – Tim Jones
Well 4% is the output rather than the input into that transaction. What we did was we set a limit of £3.5 million per pub and if a pub had a larger valuation than that we reduced the EBITDA multiple by half a turn. If the pub had a valuation in excess of £4.5 million then we reduced it by a full turn. So yes it is arbitrary, but the process is objective. What it does is it dampens down the ability for a pub to grow once it reaches that level of valuation. The output of that is the 4%.

Further Question
Just in terms of the 47% of revenues which are now food sales, what would you expect this to trend to in the long-term, i.e. how much can we expect the food to outperform drink sales by going forward?

Answer – Adam Fowle
Well it will grow? I guess it will get to 50% in a couple of years, something like that, but we can work out that, I don't have the number on the tip of my tongue though Lena, but we expect it to get to 50% at some point soon.

Question 10
Jeffrey Harwood, Oriel Securities

Yes it's Jeffrey Harwood from Oriel. Two questions. First of all can you give some indication as to the growth in the operating margin in the first two months of the year?

And secondly, how are the Christmas bookings looking?

Answer – Adam Fowle
The answer to the first is no. Because we are only just into the year and I don't think we'll do that.

And in terms of Christmas, Christmas is looking okay. We are cautiously confident on Christmas; we are looking for a good Christmas Day. Christmas Day is now the largest sales day in the year on food for us. So we are up against last year on bookings.

Question 11
Jason Streets, RBS

Jason Streets from RBS. I was struck by how small your advertising spend was, at less than a third of a percent of revenue or 1% of EBITDA and yet it seems to be quite successful. Are we going to see that change dramatically in the future?

Answer – Adam Fowle
Yes I think you will find that it's not quite doubling this year. You've just played into the hands of the marketing department! I mean we are very, no I mean it has clearly worked for us and is working. And we will seek to expand it judiciously as we go forward, but it will probably head towards double over the next couple of years.

Question 12
Nick Thomas, Nomura

Yeah just following up on that on advertising, obviously you flagged that it is probably by virtue a circle in terms of the better known a brand becomes the easier it becomes to have a big impact from that marketing. In that context can you just sort of talk about having focused predominantly on three of your brands this year for national

advertising? How much longer it might take to get the ball rolling on some of the lesser known brands?

And whether you could just also try to help us broadly quantify, given the fairly low overall spend on advertising, what kind of impact you think the advertising that you have done this year may have had in terms of what kind of boost for like-for-likes it may have provided for those particular brands?

Answer – Adam Fowle
So in this current year we have added Crown to the list for above-the-line, so we have got that going. And I think it is true to say that we are doing above-the-line but not TV for Vintage as well. So they are all sort of rolling through. I think that is right. I mean basically for it to work on the TV it has got to have a badge rather than a pub name and that is where those four brands will work and work well for us.

In terms of the, it's complicated is the answer to the second question because clearly you are looking at the impact of TV against the period where you have removed some discounting when compared to the control the year before where you had discounting. So all you can really do is look at the net line, the bottom line including all the marketing costs and the gross margin movements. And as long as that looks positive, then we think we have done a good job. That is the way we are looking at it. We have worked out ROI's but generally speaking if we get it back within the time period of the programme or just after it's finished, that seems to work very well.

Question 13
Hugh-Guy Lorriman, Seymour Pierce

Yes Hugh-Guy Lorriman from Seymour Pierce again. Could you tell us what your exposure is to AMBAC. The quantum of the debt that they are ensuring and the premium you are paying for the bond insurance? And how you view the impact of the AMBAC financial group bankruptcy?

Response – Adam Fowle
I think that is one for Tim.

Answer – Tim Jones
Yeah part of it is. They do wrap a number of the bonds within the securitisation, not all of the bonds. I will have to get back to you on what proportion of that they are and I don't know what rate we are paying them.

Further question - Hugh-Guy Lorriman
Do you see any positive that you may be able to reduce that rate a bit?

Answer – Tim Jones
Let's wait and see. I am not going to go out on a limb and say yes.

Question 14
Nigel Parson, Evolution Securities

Nigel Parson from Evolution. Have you set your rents on a sort of top down basis, so just every house pays 40% of EBITDA? Or have you done it on a sort of house by house build up basis so some houses are sort of trading very well and other houses maybe loss making or just about covering their rent?

Answer – Tim Jones
Both is the answer to your question. The rent pool has been set by reference to pub level EBITDA. Having established that quantum of £190 million, it is then allocated to individual pubs based on the cash capital that has been employed or invested in those pubs historically. So each pub isn't paying rent based on its own individual trading, it is based on the amount that has been invested in it.

Further question
And what insights has that given you?

Answer – Adam Fowle
Well clearly if a lot of capital has been invested in a brand or an Estate, they are paying a higher rent than those who have been slightly more cautious with the capital being invested in the Estate. And it brings, I mean it has only been going two months, but it does heighten the level of capital awareness in the business right up and down it.

Further answer – John Lovering
And that is the key point. We are looking for benefits, measurement and communication at this point but it also means that a large percent of capital has a direct and very meaningful effect on your fixed cost base and on your bonus pool. So it means that we've got, our Executives are always keen to deploy capital well and are now seeing a direct link now to their immediate P&L account.

End of Q&A