Mitchells & Butlers

Mitchells & Butlers 2017 Final Results
Thursday 23 November 2017

Phil Urban - Chief Executive

Tim Jones - Finance Director

Q&A

Jamie Rollo, Morgan Stanley

Just a few questions on the dividend. First of all you show in the appendix the EBITDA restricted payment headroom on the restricted payments is £22 million – that's pretty well halved in the past three years. Am I right in saying, just simply speaking, it just takes something like a 6% EBITDA drop for you to be in cash-trap? Secondly, following on from that, can you simply shift in or sell in the PLC pubs? And do you need pension funds or pension trustee permission to that, because that'd obviously resolve a lot of the issues. And thirdly as an alternative to that, how about re-profiling the bonds, pushing them out to reduce the amortisation charge. Thank you.

Tim Jones

The headroom it is what it is £22 million. Clearly, we have a lot of relationships with the securitisation group between the two estates that we've talked about, so I think I've got on a slide, that transfer pricing agreements that may offer some latitude. But that is essentially what the headroom is.

In terms of can we shift in PLC pubs? The securitisation is allowed to buy used sites, it's not meant to buy greenfield sites, it's meant to be sites that have a trading track record of I think 2 or 3 years, there's some scope to do that. I think if that's done on an arm's length basis, then that's OK to do that with our unsecured estate and the negative pledges on that.

And then lastly, I think your point was on amortisation and could we re-profile the amortisation? Technically one could do that, and we could look at that going forward, I think it's going to come at quite a big cost to do that, because we'll need bond holders to vary their terms quite a lot, and I think where we are now that cost may prohibit us wanting to do it. But I think technically maybe it is something we could do going forward.

Jamie Rollo, Morgan Stanley

Just following on from that, so if you can't put EBITDA into the structure, or reduce the debt service, then headroom's quite tight, it therefore seems quite likely you won't pay a final dividend next year either, does it?

Tim Jones

You can put EBITDA in because you can buy new sites or you can invest in the exiting sites to get a return as we're doing on the sites we've got at the moment. So there absolutely is capacity to grow the EBITDA in the securitisation and that's a lot of what this is about.

Jamie Rollo, Morgan Stanley

But do you need pension fund trustee permission to buy in the PLC EBITDA as opposed to external pubs?

Tim Jones

What you can't do for the pension trustees or the unsecured piece is just gift assets into the securitisation, because you're moving from one person's pot, to another person's pot, but you can transact.

Brian Devitt, Goodbody Stockbrokers

Just three questions from me as well. Firstly, Phil, I think you mentioned, with the new concepts, Chicken Society et cetera, that some of the initial returns have been a little bit disappointing, but customer feedback has been very strong. Could you just talk us through the disconnect there, has there been lower volumes than you previously anticipated?

Phil Urban

Let me just bring it to life for you, let's use the Son of Steak in Nottingham. Both those concepts, we aimed at the millennial market, we're sort of conscious we don't talk to that part of the market. What we've done is create an offer that we think has a real appeal to millennials and to students, and certainly in the evening period we're very very busy and we're getting good numbers through. But that site previously was a Harvester, which wasn't a particularly well-performing Harvester, but nevertheless traded three-day part breakfast, lunch, families in the afternoon and then in the evenings so, actually all we've done is replace one level of trade with another, but we've obviously not yet grown those other day parts. That's really where the disconnect is, I think we're at pains to say when we're doing both of those new concepts, part of the fact for me was that I wanted to prove to the M&B guys that we could be innovative, that we could do stuff that actually has customer appeal. Both those businesses were launched in pretty quick time, have absolutely hit the mark in terms of the social media and the customer feedback that we're getting, but what it's done is actually create an innovation ethos through everything we do. It's changed the way we do our concept evolution if you like, and that's been the welcome by-product of those two products. Will we get those two brands to roll out? Too early to say. I think both of them have the opportunity to potentially go into redundant trading spaces of existing businesses so that would be quite a good solution, but for the moment it's not a priority regardless of the things we're doing.

Brian Devitt, Goodbody Stockbrokers

And on capital expenditure, could you give us a sense of how much was spent on accommodation in the period and how much to you expect to spend this year?

Tim Jones

So last year, the amount on refurbing accommodation rooms, as we didn't open new rooms, so it would have been a single digit million, £1 or £2 million. Next year it'll be a lot more because we've got a new lodge that we're building in Melville, just outside Edinburgh, that we're building. So, a total amount on Innkeepers Lodge this year would probably be about £5-6 million, something like that.

Phil Urban

The point is I think it's a part of our market that we've been aware of, but obviously we've had a few priorities over the last 18 months to focus on first. But accommodation is now getting up the list, something I think is low-hanging fruit for us, it's a great part of the market, it's a great complement to our existing businesses. So we've now got the system right so the engine room that supports a business at this size is in place and so it's something that we are now beginning to put some real focus on. But as always there's a finite pot and you've got to back the priorities, but accommodation is one I certainly think is a neat way of sweating assets we already have.

Brian Devitt, Goodbody Stockbrokers

And just one last question then, very high level question on the outlook. Obviously you're very keen to stress the level of uncertainty in the market today, as you see it, more so than you did at the interims. I'm just wondering – obviously trading's got better, broad market indicators are still not great, but probably not a whole lot worse than they were 6 months ago, so what exactly was the trigger, can you give us some colour on your thought process over the last few months and how your mind-set on your view of the market has changed?

Tim Jones

I mean you'll read the press as well as I – the press is full of uncertainty, Brexit, far from clear and I think that probably the new news since the interims is the political instability that we now have. I think those factors make it very very difficult for anyone to predict with certainty the macro-landscape so yes you're right. We're delighted with how we're trading, we're pleased with that progress and to some extent I guess we're bucking the trend of what we read in the press, but there is a fair degree of uncertainty and we just feel it's difficult to call it so, hence why we're being cautious.

Tim Barrett, Numis Securities

A couple of quick things, can you say how many freeholds are in the PLC estate please? Quick question about maintenance capex: is £53 million sustainable? It feels like quite a low percentage of group revenues. And then I suppose just a broader question on leverage. Is £80-90 million the right level of amortisation, or is there stuff you can do elsewhere in the debt structure on a longer-term basis.

Tim Jones

So of the 1346 sites in securitisation I would say 90% would be freehold. As a group our percentage is about 82-83%, but the unsecured estate would have a higher proportion of leasehold, so it would be richer than that in the securitisation so 90% would be there or thereabouts in answer to your question.

Maintenance capex, I think we had a lot of success with maintenance capex this year, we've had a new regime around how we look at and how we prioritise jobs which I think will save us a lot of money. We've got onto a shorter remodel cycle, so we're on 6-7 years now, rather than the sort of 10-12 we used to be. So quite helpfully we've seen coming through on that, a lower spend requirement on tired sites, tired pubs to maintain them, which should continue. Going forward however as I said in my presentation, it'll tick up a little bit because we've got about £10 million of IT capex spend that's going to be coming through – we're doing a big project on our infrastructure with Fujitsu. So it'll tick up this year, in answer to your question, but that won't be related to sites.

And then you had a question on amortisation, is that the right level. The best place to look is probably the supplementary slides, where we have a sort of landfill chart. It's near the one Jamie referred to which is on the covenant summary. That gives you how the securitisation works, the sort of amortisation profile moves out. It's essentially like a domestic repayment mortgage – our debt service is fixed at just under £200 million, and then we have a growing richness of capital repayment within that. So it was £77 last year, it'll be £82 this year, so it's going up every year. But crucially your debt service isn't, because your interest is coming down to offset it. So we have a sort of constant debt service requirement.

I think the second half of your question Tim then is very similar to Jamie's: is there anything you should do about it? Clearly, we've got £1.8 billion of debt now in the securitisation, there's properties in there worth double that, probably, so there's a bit of headroom. Technically, one can look at tapping it, technically one can look at re-profiling the amortisation. The problem is they come at a very high albeit prohibited cost, while we're so far out from the end of the life of the securitisation. So we don't think that's a short-term fix for us at the moment. Far better that we act early and long-sighted on our capital allocation and manage the group on a responsible basis now, than end up paying away what could be £100s of millions of fees to have to rush to change the securitisation arrangement.

James Ainley, Citi

I think you used to give a breakdown of like-for-like sales split into price and volume, could you give us that today please? For the last year and for the current trading period. And then secondly, some colour around the pattern of trading: there's been some comments about the value of the food segment in particular, so I'm interested to know whether that's an area of weakness and where you are perhaps making it up elsewhere in the group. Thanks.

Phil Urban

I'll answer the latter first then I think we'll come back with the volume piece. So, I think the question is are we seeing a difference in performance across value to premium? At any point in time you always have a spread of brands, I think it's fair to say that the premium businesses have been our strongest performers, but I wouldn't particularly point to any weakness in our brand line-up. I think within the sector you're right, I think businesses that are purely beating on a price point are probably those that are struggling the most. But we have sort of systematically weaned ourselves off that, that's not to say we don't do discounting, but we have been working really hard to get our brand propositions front and centre, and to sort of compete on that as the main communication vehicle. So I think it'd be wrong to say that we've got a particular weakness in any of our brands, but it's the premium end that's been the strongest.

Tim Jones

Price and volume: if you look back at last year, we had like-for-like food sales growth of 1.4%, underlying that was a volume decline of 4%, and we had like-for-like drink sales growth of 2.1% and underlying that was a volume decline of 1.8%. So what would I say about those declines? Firstly, that we are outperforming Peach market volumes.

Secondly, I think that there are slightly lower levels of decline than we'd had last year and through the year if you like, so it's trending in the right direction.

In terms of the first 7 weeks, clearly sales have come up, that sort of delta in sale has been driven by trading rather than price so the benefit in that improvement will have largely been a continuation of the trajectory of those volume numbers.

Anna Barnfather, Liberum

Two questions please. When you mentioned the second wave of initiatives, you referred to 'slaughtering some sacred cows': could you expand on that a little bit please? On cost inflation, you're sounding much more cautious on the outlook for cost inflation, what is new or has specifically changed since you last spoke? The FX is sort of lapping, so is that just the delay on the contracts that were in place?

Tim Jones

I think let's take that last one first, overall our guidance on cost inflation is that it's about the same in total as last year, but the make-up will be slightly different, so as you say last year we had the movement of sterling, this year maybe sterling will be more stable so we won't have that movement, but we do have a series of contracts that get renewed at certain times, so the impact of that sort of takes time to come through. And also, every year we get new costs coming our way, so halfway through this year we'll have sugar tax - that will add £4 million to our cost base, pre-mitigation. Auto enrolment also goes up in April, so the height of each individual bar is going to change, but broadly the picture is the same in total in terms of the cost inflation that we're facing.

Phil Urban

I'm more optimistic this year than I was this time last year. I think the ground we've covered in putting those system changes in mean we're in a far better place to mitigate for those costs. It's an age thing but – I've forgotten your first question, sorry.

Anna Barnfather, Liberum

The sacred cows.

Phil Urban

Simply when you run a business like ours with brand directors running, and obviously directors running brands, then of course people always like to do things their way for their brand. Which is right, and I'm a big fan of businesses structured as we've got them, but you know, sometimes as you step back in my seat and you look at M&B, if you look at it through Mitchells and Butlers' lens you might say well, actually, whilst you feel this is really important for your brand over here, if you compromised on that, we would get a better price across the whole business, and so it's getting the right balance. I think it would be wrong to take a central approach and have a very vanilla approach to each of our brands and our product selection and the way we do business, but equally I think it's wrong to let it just be a free for all for the brands because then you lose all the scale advantage. What I am alluding to there is that we're sort of getting the whole organisation geared up to the Mitchells and Butlers lens and that with some of the decisions they're making locally there's a bigger impact for the wider business.

Douglas Jack, Peel Hunt

Three questions, we'll do one at a time if that's alright? You talked about a lot of innovation coming through and £26 million of cost savings last year, £26 million of cost savings this year, what can we look forward to in 2019 in terms of the flow through of that innovation into cost savings in that particular year.

Phil Urban

I think this second wave of initiatives should be absolutely in full flow in 2019, so I suppose specifically around cost, another step-change in our labour, I mean the labour systems, without getting too technical, the first thing you have to do is know what your forward forecast is for your sales, and your sales mix by day-part, and against that you can then do a roster. So it stands to reason, the more accurate your sales forecast, the better your rostering.

And so, this investment we're looking at has a more sophisticated sales forecasting engine which will take out a lot of inaccuracy in sales forecasting, which you inevitably get across several hundred businesses, which therefore means the rostering is that much tighter. So, this should deliver another step-change again. That's one example, similarly with stock I think, the auto-ordering and the prep and par. We've got some clever systems to look at how we track the product right the way through our business. If those work, which I think they'll work, once again it can step-change performance in those areas. So they're just two of the seven streams, but I think that second wave of programmes should be an engine room for 2019, 2020 and beyond.

Douglas Jack, Peel Hunt

How much of your like-for-like sales growth was delivery in 2017, and how profitable is the delivery that you're doing?

Phil Urban

It's still small. I would say it's fairly immaterial in the sense of where M&B is, but we've partnered with Deliveroo as you know, we're also partnering with Just Eat, we see the opportunity for taking it to another 300 (potentially) businesses. In terms of profitability probably about £1-2 million?

Tim Jones

I mean clearly you pay a margin away to the delivery company, but you save the labour on doing that so, if you take the view that it's marginal volume, which we do, then it's not really going to change the overall cost structure of the pub.
I think it would if you had a significant proportion, but at the levels we're at it's just another dish and it happens to be in a bag and you haven't got any labour.

Douglas Jack, Peel Hunt

And the last question: you said about £35 million of onerous lease provision in relation to sites in leisure and retail parks, how many sites was that how many do you have in leisure and retail parks, and why are they trading so much worse?

Tim Jones

So there's 50 sites that went into that. Most of them will be Harvesters. I think the outlook has changed so we've struggled more with these sites. I think footfall on a lot of those parks has gone down and that's been more challenging than when we made the investment five or six years ago. And I think all of the cost headwinds we've talked about combined with that reduction in footfall gives us a very different outlook for what we can do and what we can make with those pubs. Now it's absolutely not because we've given up on them. We're all working very hard to turn them around where we can, to look at innovation, to look at changes to the offers or the service cycle but the outlook they face is now significantly different than it was a short while ago.

Phil Urban

And also, if footfall's down on that site, be it through online shopping or a better shopping area in a particular vicinity, then our businesses suffer along with everybody else and I think that is probably why those leisure parks are underperforming.

Jeffery Harwood, Stifel

Two questions on the dividend. First of all, you seem to be more confident than you were six months ago, so when we are sitting here in twelve months' time, unless the wheels have fallen off the economy or there's been political change, are you likely to pay the same level of dividend? And then secondly, do you think there's a difference of opinion on the dividend between the two major shareholders and institutional shareholders in general?

Tim Jones

In terms of confidence, we are more confident in what we are doing with the business, and we are starting to see the benefits of the initiatives we have taken come through. So that gives us confidence. Externally, as Phil said earlier on, we are healthily very concerned about the environment. I think it is tough at the moment and it could get a lot tougher and if we have a change of administration that would be a big change for the cost structure of us and everybody else in our sector. So that is really what has led to our position at the moment and that is why we are paying the dividend today for last year because we've traded well and we are where we thought we were going to be. But we do need to articulate to you that we could be going through some very difficult times so there is two edges to that confidence, if you like, going in different directions. When we get there in twelve months' time, it is a multi-dimensional decision. It is not going to be just based on trading this year it will be on prospects at that time and our capital requirements. So are we likely to pay one? I just cannot answer that question. We haven't made the decision. The whole point of not announcing a dividend is because we don't think we are in any position to make that decision probably in May let alone now. And that's why we want to take a whole year so I just can't answer that question. We just have to see where we are in twelve months' time.

In terms of a difference in opinion there's a spectrum of investors and they'll all have different views I guess on what they would like us to do with our capital allocation and financing strategy and our balance sheet policy and I'm sure if we looked hard enough we could get a shareholder in every different camp. But we've had a lot of debate about this as a Board and the shareholders quite rightly sit on the Board feed into that debate, but so do the independent directors, and the executive team and we've come to this position as a Board because we think the most important thing is to protect the health of our group, the balance sheet of our business and the condition and competitiveness of our estate going forward, and that's why we've called out what we've called out at this stage.

Richard Taylor, Barclays
At the interims you gave us a list of the number of sites you have on Deliveroo, could you update us on that please? And also the weekly take per site? And secondly on discounting, has yours gone up, down or about the same versus the interims? I'd be interested in a similar comment for the industry.

Phil Urban

While my learned colleague is looking up the answer to the first question, I'll answer the second. Discounting in my view discounting has certainly increased, but it pays to say that discounting has always been a legitimate, tactical response for businesses such as ours, so I'm not sitting here saying we don't do it, of course we do. I think the big change for me anyway is that discounting going on at peak periods where traditionally big businesses would not discount, is now sort of common practice. And we don't follow suit in that respect, and I when I see some of the level of discounting it says to me some businesses are really struggling. What happens if a competitor discounts, you're left with a decision, because it certainly impacts your business, if a competitor does a really bold discount for a sustained period. We can see it in our numbers the very next day, and you're left with that decision, do you follow suit, or do you not? We have resisted so far, the temptation to fight fire with fire, because I think you just get into that spiral and I don't think it's sustainable to do the level of discounting that we're seeing. But we will always continue to discount, but it's certainly been on the increase in the market at peak times.

Richard Taylor, Barclays

The level of supply, have you seen pockets where it's reduced yet, which has been positive for you? Or are you still a bit early in that game.

Phil Urban

I certainly think that from where we were 18 months ago, it's normalised now, it's probably always healthy for the industry to have new entrants coming in, new ideas and it shakes up the market, keeps people on their toes, and I would say that sort of normal level is what we're experiencing at the moment. That growth we saw two years ago has disappeared and I think that's probably given everyone a chance to retrench and recover and I think one of the reasons that we're being successful is that we've had that sort of headroom now to get our propositions right, to reinvest in the bits of the business that hadn't seen investment for too long, and that's why you're now seeing the strength of the brands come to the fore. Will it change? I'm not expecting a massive return to the levels of growth in supply we saw 2-3 years ago, not for the short term anyway.

Tim Jones

In terms of Deliveroo, we've got just over 60 sites that we work on with them they're largely Miller and Carter and All Bar One brands and there's quite a lot of variance in sales actually between different sites. Sales average out at around £700-800 a week, so £100 a day if you like, but some with substantially in excess of that and others very low. I think the statement also refers to Just Eat who we've just started working with, which brings into play Harvester and Toby Carvery. It's a slightly different model, that's at a more nascent stage though in terms of trialling it. A lower level of spend as well, we're probably looking at £300-400 per week. But I think looking forward in the first half, if things are successful, that's the cohort that would be growing most steeply when we're updating you in May.

Richard Taylor, Barclays

Thanks, and why have you chosen those two, out of interest?

Tim Jones

They're not all pan-national, they also have slightly different customer profiles that tend to use them. We actually have some All Bar One that are also with Just Eat for example because Deliveroo don't have coverage in certain areas.

Phil Urban
We are talking to other providers, but they're the two who we're on trial with currently.

[UNKNOWN QUESTIONNER]

Just a question on the cash-flow statement. So you had the proceeds from the disposal of a number of pubs this year, are you able to give us an outlook for the cash you might get from further disposals in FY18?

Tim Jones

So to put that in context, we've got £46 million of cash disposal proceeds this year, if you go back 5 or 6 years we really didn't sell many assets at all, you only see £1-3 million a year, so that came out of a periodic state review. I think you may see us selling assets going forward, but I think perhaps it's not going to be at that level this year, next year and the next year, I think it will probably come off a little bit and then periodically we'll assess where we are, what we can premiumise, what we can't premiumise, what we can get growth from. And they'll come out in a bundle. So I think if you're trying to model it going forward, you shouldn't model a substantial level of disposal proceeds.

[UNKNOWN QUESTIONNER]

So just so I understand how you think about it, So you're selling when a site's not doing too well, when you can't premiumise it, that's when you're looking for a buyer?

Tim Jones
You look at the value of the asset, and you look at what you can do with the asset. That might be making it better in the brand that it is at the moment, clearly option number one, that might be changing it or that might be putting in a new proposition in or premiumising it. But we go through all of that sort of criteria. Probably the last one is we have the ability to put it into a very small franchise estate so it could be a freehold that we don't want to give up the ownership of the asset but we don't think we can do much with it so we might find a tenant but we only have about 50 or 60 sites we'd do that with. That's a sort of last step in a warehouse if you like, and then after that we'd sell it.

No more questions? Thank you very much.