MITCHELLS & BUTLER RETAIL PLC

Moderator: Alistair Darby
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4:00 a.m. ET

Operator: Good morning, ladies and gentlemen, and welcome to the Mitchells & Butlers' trading update conference call. At this time, all participants are in a listen-only mode. And to (re) conduct and answer session and instructions will be given at that time. If anyone should require assistance during the conference please press star then zero on your telephone.

I'd now like to hand over to the Chairperson, Mr. Alistair Darby. Please go ahead, sir, and I will be standing by.

Alistair Darby: OK, thank you, Anton. Good morning, everybody. I have Tim Jones with me.

What I'd like to do is take a few minutes to talk through the key points of our trading update, and then Tim and I will be happy to take any questions which you'd like to ask.

The transformation of our business is on track. During this year, we've concentrated on winning back food and drink volume by providing great value to our guests, and by taking a careful approach to price increases.

We've accelerated our remodel program; continued to invest in our people; and we've driven hard the rollout of our new pub systems which are now installed in more than 1,000 outlets. If you remember, we started that program only about a year ago.

We've also invested in new technology such as tablets to enhance the provision of management information to our operational teams.

Three months ago we acquired 173 largely freehold pubs from the Orchid Group. These pubs are trading well.

Integration of the Orchid business into ours is moving ahead at pace, and we expect to have converted around 10 pubs to our brand by Christmas. We're excited about the pipeline of conversion sites that exist in Orchid, and we will be stepping up that program as we planned, through 2015 and into 2016.

It has been widely reported that trading conditions across the pub sector were difficult in August. There are many kind of thoughts around that, but what I would say is that unseasonably high rainfall didn't help, particularly when you have for example a deluge on a key trading day like Bank Holiday Monday, which I think was a washout for most pub operators.

I'm pleased to say that September is proving to be a better month, and we're pleased with the progress we are making.

I should say, however, that we think that consumers will still spend carefully and cautiously whilst wage rises stay below inflation. Until consumers really feel extra cash in their pockets, we expect there to be continued volatility in spending on a month-to-month basis.

Notwithstanding that, we're confident about the growth momentum building in our business as our volumes improve, our transformation plans mature, and the integration of Orchid proceeds successfully.

I would now be delighted to take any questions you may have, and I'll hand over to Anton to preside over that part of this meeting.

Operator: Thank you. Ladies and gentlemen, if you do have any questions at this time, please press star, followed by one, on your telephone keypad. And the hash or pound key to cancel that question. So once again, that’s star followed by one to register your question.

Our first question comes from Victoria Greer.

Victoria Greer: Just two questions please. The first; on the comment you made around volumes, could you give us a feel for how volume versus prices is trending across the business? Are you still seeing, in food example, volume growth but price is flat to down?

The second one; on the weak current trading environment. Some of your peers have been saying that they're seeing more discounting across the sector. I wonder if you think that you're seeing that, and if so, what you think is driving people to make that decision?

Alistair Darby: Well I'll let Tim address the question of volumes, and then I'll give my views on discounting.

Tim Jones: Your summary there on volumes is correct, Vicky. If I split it into food and drink, on food we are in volume growth, and that growth is slightly stronger than we saw at the half-year. And price or spend per head certainly recently has been flat or even negative in some periods. So absolutely all of our food growth is coming through volume with virtually no contribution from spend.

On drink, we are still in a negative volume – in a decline on drink, but far slower decline than the 4.5 percent we saw last year. So again, similar to what we saw at the interims there, with some moderated price increases coming through drink as well.

Alistair Darby: As far as discounting goes, there's no scientific way to calculate the kind of level of discounting that's prevailing in the market at any point in time.

I think there's some evidence that after a difficult August, people have stepped up discounting to compensate for a weak August, but I would say that it's been fairly carefully targeted, and it's what you would expect, particularly as we come out of summer into what is – kids go back to school, and so on.

So yes, there is discounting in the market. Is it significantly more than was the case last year? Well maybe at the margin, but I wouldn't say – I can say that it's massively greater than may have existed this time last year.

Victoria Greer: Great. Thank you.

Operator: Our next question comes from Tim Barrett.

Tim Barrett: I also have two things, please. Taking Vicky's question a step further really. What are you doing on promotions, and can you just clarify the source of that decrease in spend per head? Is it coming from operational activity or just trading down the menu really?

And a second question, probably for Tim. The pension top-up you agreed, the GBP40 million accelerated payment, should we put that in for this year or next year now? Thanks a lot.

Alistair Darby: OK. I think, as you would expect, our efforts to drive volume back into our business spread across a whole range of initiatives. So clearly, providing exciting menus that have got good value on them is important; attractive offers. You may recall that, at the half-year, we talked about offers such as GBP9.99 in Harvester where, giving people an all-inclusive deal so they know what the bill is going to be at the end of the evening is really important, so that's obviously contributing.

I think another thing I would say that will have an impact on spend per head is the growth of our breakfast business which, of course, breakfast is at a lower ticket price than say an evening meal, for example. So there's also a bit of spend per head dilution that is coming from the strong growth of our breakfast business.

So as I said, it's quite a complex picture and our efforts to drive volume are being driven by a whole range of initiatives.

Tim Barrett: Thank you.

Tim Jones: And on the pension, Tim, you should assume that that GBP40 million is next year, so FY15.

Tim Barrett: Great. Thanks a lot.

Operator: Thank you. Just to remind participants, that's star followed by one to register a question.

Our next question comes from Douglas Jack.

Douglas Jack: The first one was really about the expansion. It looks like you've done 22 new sites in 2014, and I think last guidance was for 40 for 2015. Are you still confident of that sort of number, given what you're doing with Orchid, which seems to be quite a big program at the moment?

Alistair Darby: I think, having completed Orchid, Doug, I think your suspicion is correct, that we will temper the pace of the expansion program within, if you like, the core M&B estate. We were talking about that ramping up very quickly over two or three years to fit the openings a year. I don't think that will happen now, at least until we've digested the nearly 100 Orchid conversions we're doing.

So whilst we've done 22 so far this year, actually we're opening – we're opening Miller & Carter at Newcastle I think today, so it will be 23 in our full-year numbers. I suspect next year will be a similar number, sort of 25, and the only other difference is that next year's (total) will probably have a (rich) of freehold mix in them as well.

Douglas Jack: OK. That's great. And in terms of the timetable for the conversions at Orchid, how long do you think it will take? Can you just remind us of the original number of outlets; how many you think you might sell, how many will be converted? All of that as well, if that's OK.

Alistair Darby: Yes, so of the Orchid estate of 173 sites, we have current plans to convert 96 of those to our brands or formats. That will come at a cost of about GBP35 million, and we will complete all of those conversions over a two-year period. So the first will start in a couple of months, and you should assume, if you wanted numbers, I will assume it happens equally over FY15 and FY16 for us.

Douglas Jack: That's brilliant. And then just last from me, in terms of cost outlook, can you just say if there's been any change? What's the outlook at the moment on food, utilities, labor, in particular?

Alistair Darby: OK. So labor, we're driven by the minimum wage which you can see as much as us; it's gone up 3 percent, so that's what we're facing in the near term. Obviously, looking further out, both political parties are making noises about more aggressive increases, but that will be a medium to longer-term challenge for us in the sector, if it happens.

Food inflation has been remarkably benign the last six months or so, and I think that is our view of the outlook. Two years ago, we were really quite concerned about food price inflation, but I think that's been a lot more gentle for us than it has been.

Energy/utilities a bit higher, I think; we're looking at around 5 percent,/6 percent increases in energy and utility bills.

Douglas Jack: OK, that's great. Thanks very much.

Operator: Thank you. Final reminder to participants, that’s star, followed by one to register your question. We have a question from Jeffrey Harwood.

Jeffrey Harwood: Looking at the operating margin, there's obviously been a fair degree of pressure on that this year. What confidence do you have in being able to stabilize the margin next year?

Alistair Darby: Well, there are three main drivers that are accounting for the decrease in our margins in the current year, so let me talk about those and how they will pan out.

Firstly, we brought in Orchid and, at the moment, Orchid earns lower margins than the rest of the M&B estate. And that's particularly so because we haven't started to realize the bulk of the synergies, such as closing their head office and getting all of our purchasing arrangements in. So Orchid is diluting our margin this year.

The second is, we are accelerating our remodel program. As we do that, as you all know, we incur pre-opening costs, we incur closing costs, and that is margin dilutive for us.

And the third element is our sales growth at the moment, particularly in food as we talked about, is coming, basically, from volume rather than price. And that, obviously, has margin implications for us.

So they're the three drivers to a weaker margin in the current year. None of those are elements that we think will be with us in the medium term. So they're headwinds that we'll carry into FY15, but all three of those should dissipate at the time as we start to be able to take a little bit more price in food; as we cease to have to accelerate the remodel program; and as we achieve the synergies that come through with Orchid.

So I think as we look to the FY15, the year we're going into, I don't think it will get back to the previous margin in one go, because it will take us a while to do that. But by the time we get to FY16, we should be – those three factors should have dissipated.

Jeffrey Harwood: OK. Thank you.

Operator: Thank you. There appears to be no further questions at this time. I'll now hand back to you.

Alistair Darby: Great. Well, thank you very much, everyone, for coming on the call, and have a good day. Thank you.

Operator: Thank you. Ladies and gentlemen, thanks for your participation. This concludes today's conference. You may now all disconnect your lines and, once again, thank you.

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