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Mitchells & Butlers plc

Pre Close Trading Update

Corporate Participants

Adam Fowle

Mitchells & Butlers – Chief Executive Officer

Erik Castenskiold

Mitchells & Butlers – Director of Corporate Affairs

John Lovering

Mitchells & Butlers – Chairman

Conference Call Participants

Paul Hickman

Peel Hunt

Jamie Rollo

Morgan Stanley

Lena Thakkar

Bank of America

Nick Thomas

Nomura

James Ainley

Citi

Ben O'Toole
HSBC

Nigel Parson
Evolution

Hugh-Guy Lorriman
Seymour Pierce

Geoffrey Collyer
Deutsche Bank

John Beaumont
Matrix Group

Questions and Answers

Operator
Paul Hickman, Pell Hunt.

Paul Hickman – *Peel Hunt*
Good morning. I guess the outstanding number here is the 7% food like-for-like in the 9 weeks. I wonder if you would be able to analyse that to some extent between price increases, new menus and various types of marketing actions such as moving up the menu scale and the purchase of extra items on the menu. That is one. Then my other question is just whether there is any variation in the likely level of pre-opening costs between single site acquisitions and conversions.

Adam Fowle
Paul, I think the 7% is pretty remarkable. There is around 1.5 or so percent of volume in that, and the rest is spend. Like-for-like menu items is flat, so it is all spend and it is all tickling people up the menu and importantly in the Premium channel, moving people into two courses away from one course; and that has had a big impact here.

On the second question; the big advantage – I mean there are lower pre-opening costs with a new-build, because there is no closed period and there are no redundancy costs associated with changing the staff mix, so they're slightly lower.

Operator
Jamie Rollo, Morgan Stanley.

Jamie Rollo – *Morgan Stanley*
On the £200 million of Capex; could you please split that between maintenance, conversion spend and spend on new site deals. Then on the new sites and deals, could you break out the non-Ha Ha spend and give us the number of pubs that you're assuming within that please?

Adam Fowle
There will be about £110 million of maintenance and IT. There will be around 40 million on conversions and around 50 million on small packages and single site acquisitions, and around half of that 50 million will be the Ha Ha deal.

Jamie Rollo – *Morgan Stanley*
And of that 25 million on new sites, clearly you have bought about 20-odd pubs today you have exchanged or you're about to exchange on. Is that sort of 1 million or so per pub a reasonable figure going forward? Is that £25 million of non-Ha Ha spend a reasonable figure for next year? Could that step up going forward?

Adam Fowle
Let me come back, it could and should step going forward. We have not been working at this single site and small package pipeline for long, so clearly it is building momentum. The average cost will depend on the mix of leaseholds versus freeholds i.e. retail parts versus pubs. But I would have thought the average cost of around a million or so is probably about right going forward.

Jamie Rollo – *Morgan Stanley*

What is your ideal number of new sites, non-block deals, non-acquisitions; 50 a year sort of double the figure for next year?

Adam Fowle

I think we can comfortably cope with 50, but I think we will be looking for small packages as well because it is an efficient way of buying sites. I would have thought at least 50 next year, all things being equal. It may ramp up a little further as well.

Jamie Rollo – *Morgan Stanley*

Then if we just look at the second half performance which is obviously very good at the margin level. Your margins were up I think 80 basis points year-on-year, now you have given us the sales and the EBIT number. I am just looking at the mix of costs and sales. Your total costs look like they fell 1% in the second half, and your sales were flat. I am just wondering whether there were any additional cost savings you made. Clearly you did sell some assets, but they were largely higher margin units, the Lodges and Hollywood Bowl I think. I am wondering what caused that skew in the second half of the year. The first half of the year your costs were flat, but your sales obviously grew by 1.5% or so in total terms.

Adam Fowle

I think probably the driver of that difference is our food gross margin, which has proved to be strong. We have managed the hold food inflation flat for the year and we have had good spend per head increase as I said, in what I call the 'non-main meal items', which tend to come at a higher margin for us. I think that is a contributor to that. Cost control has remained good. We had a good second half performance on labour.

Jamie Rollo – *Morgan Stanley*

Great. Then one final one if I can. On your bank facility; could you remind us when it expires and also when you might need to take a decision to extend it. If you do extend it, or if you don't need it by then, would you be happy to cancel it and maybe raise a new facility, if for example a large deal crops up and need to raise more debt.

Adam Fowle

I think the answer to the second part is yes, and the answer to the current facility, it closes in December 2011. We have to do something before then, if we have made a large acquisition. The way we're looking at it is we have got flexibility here as we go forward to either use that facility or indeed not, depending on whatever large scale acquisitions might or might not be made.

Operator

Lena Thakkar, Bank of America Merrill Lynch.

Lena Thakkar – *Bank of America*

Hi there. I just wanted to drill down into that margin a little bit more. Maybe you could give us a feel for how much of the cost savings have been achieved this year out of what was announced at the Strategy Update and how much you have left to go for in the next year or two?

Adam Fowle

I think the big bit left to go for, is we mentioned in the Strategy Review that we were re-tendering our non-drink supply chain. That is a process that is coming to an end, and when we update the market at the end of November we will be able to give some colour on that, but we expect to be able to deliver on that, I think pretty much what we said we would do. Outside that, I think Lena we're doing everything we said we would do, unless you can think of something that we haven't done yet.

Erik Castenskiold

I think the net operating margin guidance that we gave of going for 200-300 basis points improvement on the 15.3 is continuing, so we did 1.2 percentage points now and we're looking to improve on that next year. We probably wont get as high as 1.2 percentage points, but we're looking to improve on the position again next year.

Lena Thakkar – *Bank of America*

That guidance of 2-3% improvement, does that include the mix effect of disposals and acquisition, or is that above and beyond that target?

Adam Fowle

We have to include the mix effect of that on the way the business is modelled going forward.

Operator

Nick Thomas, Nomura.

Nick Thomas – *Nomura*

Good morning. I wonder whether you can just talk a little bit about the pricing trends that you have seen in your estate, in terms of like-for-like pricing in recent months, and link that in with your future plans in relation to the VAT increase that we're going to have next year, and what you might be planning to do in relation to that, whether it will be similar to what you did last year. Finally; whether you can just give us some initial thoughts on the cost outlook going into next year.

Adam Fowle

On drinks pricing we have been putting through same-drinks price rises, because we have to do that in order to maintain margins in the face of the duty increases, so that has been going on. I would expect that to carry on as a trend through next year. On food price, we have through the year tried to hold same-dish prices flat. But in preparation for the VAT rise in January, there are some same-dish price rises now going through, to a degree masked or assisted by different promotional or marketing programs. It doesn't come across accrued price rises, something going on as well within the offer. I think that you can expect us to pass on VAT in that manner, ahead of January.

John Lovering

I think we should stress there Adam that obviously that is a commercial decision that needs to be taken near the time. Even if we knew, we would consider our policy on that to be highly commercially sensitive. I don't think we really want to speculate on our future pricing strategy. I think we could happily comment on the past but not on what commercial decisions we might take ongoing.

Nick Thomas – *Nomura*

Anything at all on the cost outlook going into next year?

Adam Fowle

There are some regulatory costs, the usual duty and a bit on labour, minimum wage, holiday pay. There is I suppose the spectre of some food cost inflation, although that is very unclear at the moment, it is quite some way out. But obviously the jump in wheat prices may or may not have an impact as we go through the year. It is too early to put a finger on that.

Operator

James Ainley, Citi.

James Ainley – *Citi*

Answered already, but could you give us a little bit more colour in terms of what you see in terms of an acquisition pipeline. Are there a large number of opportunities available to you in the building well. Secondly, can you talk about what the impact of your TV advertising campaign was and do you plan to continue doing that going forward? Thank you.

Adam Fowle

I think the retail park pipeline is looking robust. The small package pipeline really does depend on what comes up, so one is reasonably robust and the other will change and evolve as other people decide to sell their assets. The TV advertising we did in the summer after the World Cup, it worked well, in line with the results we saw on previous campaigns and we're encouraged by it. We will be doing it again, probably to the same level of intensity as next year, but we will make those decisions as we go through the year.

Operator

Ben O'Toole, HSBC.

Ben O'Toole – *HSBC*

Morning guys. I was just wondering if you could perhaps expand on an earlier point that you talked about. You talked about moving people up the menu, specifically going from one course to two. Just how big an opportunity do you think that is? Can you just talk about which brands are benefiting from that the most? I know historically you said that the value end has been tougher as well versus the others. Is that still the case?

Adam Fowle
Nothing has materially changed in terms of the difference between the channels. We see continuing mileage to be delivered going forward in this kind of social dining part of the market, sector of the market where people go out there for more than just for food. It is particularly prevalent and the opportunity exists particularly in the Premium, in the city Country channel.

Ben O'Toole – *HSBC*
Do you have a number in terms of overall sales; what food is at the moment? I think it was at 40% last year. I was just wondering if you will update on that.

Adam Fowle
For the retained estate going forward?

Ben O'Toole – *HSBC*
Yes.

Adam Fowle
47.

Operator
Nigel Parson, Evolution.

Nigel Parson – *Evolution*
Gentlemen, my questions have been answered. Thank you very much.

Operator

Hugh-Guy Lorriman, Seymour Pierce.

Hugh-Guy Lorriman – *Seymour Pierce*

Good morning Adam and Erik. It is Hugh-Guy Lorriman from Seymour Pierce. You used to give some guidance on what like-for-like sales would be needed to keep operating margins flat. Can you give that again for next year, where you see the like-for-like that is needed in your business to keep a flat margin?

Adam Fowle

Hugh no not right now is the answer, not because we're being obstructive, but it is not something we want to do on a Trading Update. As the shape of the business changes that number will have moved around a bit as well.

Erik Castenskiold

Hugh just in context, we gave that partly when we had a high amount of inflationary cost pressures. There will, as Adam said be some inflationary cost pressures going forward. However with efficiencies and also particularly with the like-for-like sales growth that we have got and the margin momentum that we have got, we're not in that realm of just offsetting those cost pressures. As we have said there is good margin momentum going forward, and good like-for-like sales growth. We look for growth going forward at the moment.

Hugh-Guy Lorriman – *Seymour Pierce*

I suppose putting it another way, because you said that you would see that your margins would continue to evolve upwards, to try and give a little bit more colour on that. You would expect, let's say I half the level of margin growth as last year and that would come half from like-for-like.

John Lovering

I think Erik has answered the point and Adam has explained we won't be amplifying on it at this time.

Hugh-Guy Lorriman – *Seymour Pierce*

Then the other question I had was if you can split out some of the trading numbers, the like-for-likes on the total and the nine weeks between the three segments, City, Value and Suburban. That would be very helpful.

Adam Fowle

We don't give specifics Hugh, but I think it is fair to say that as earlier in the year, the Value channel is finding it more difficult than the Suburban channel which tends to lead the pack, and the City and Country channels.

John Lovering

I think it is pretty much as it was last time we disclosed it.

Hugh-Guy Lorriman – *Seymour Pierce*

So Channel is still struggling then?

Adam Fowle

I wouldn't say struggling; it is just not performing as well as the others.

Hugh-Guy Lorriman – *Seymour Pierce*

But it is in like-for-like growth?

John Lovering

I think we have commented on that as far as we want to go. It is a Trading Update, not the Full Presents presentation.

Operator

Geoffrey Collyer, Deutsche Bank.

Geoffrey Collyer – *Deutsche Bank*

Morning guys. I think Jamie asked nearly all my questions, so I have got a couple left. Can you just remind us in terms of the 45 sites that you got in the concrete pipeline, whether they're leasehold or freehold? Secondly, if you look a the step up in Capex that is coming through post the disposal program, it looks like it is going to take two or three years to offset the dilution from disposals. Given where you are in terms of like-for-like growth and your expectation on margin; how far do you think that timeframe is going to shorten? Unless of course you make a big acquisition.

John Lovering

I think the last question; the answer is it all depends.

Adam Fowle

On the pipeline Geoff, if you strip out the Ha Ha deal, it is about 60% leasehold, 40% freehold, something like that at the moment, but that may change.

Operator

Jamie Rollo, Morgan Stanley.

Jamie Rollo – *Morgan Stanley*

Thanks. Just a couple of quick ones if I may. Is the target to reduce the central overheard from 4.3-3.7% still achievable given the disposals I guess that increases that ratio to sort of somewhere near a 5%? I presume you're going to bring it down by sales growth rather than hard cost reductions anyway. Then the other one is just in terms of the Ha Ha deal and the expansion of Browns and All Bar One, which I don't think were part of the six expansion brands; what are your latest thoughts there? Are you still looking to go up to 1,900 licensed catering outlets on those cyclical brands? Thanks.

Adam Fowle

On the overhead, yes the target still remains the target. Yes, sales will be part of the driver but also hard cost reductions are on the table and being worked through, as a consequence of the reshaping of the business. What is the second question Jamie?

Jamie Rollo – *Morgan Stanley*

Browns and All Bar One.

Adam Fowle

Thanks for the prompt. We set out in the strategy that we had active growth expansion brands on selective, and we said at the time that the selective ones would be expanded by opportunity; Ha Ha was precisely that. We see no reason to believe that the big six, as it were, couldn't still reach those targets. It just so happened that the first opportunity that came along seemed to slide into the smaller brands.

John Lovering

I think it is also true to say that we actually set any of our brands the challenge of reaching critical mass in the Group. Although we identified the six core brands in our statement, nothing would delight us more than to see Browns and All Bar One and indeed any of our other smaller strategically relevant brands grow just as fast as they can.

Operator

John Beaumont, Matrix Group.

John Beaumont – *Matrix Group*

Good morning Adam and Erik. Just wanted to clarify Adam, I think you said earlier to an earlier question that the average cost of I think it was development on your pipeline was going to be about a million Pounds. I just wanted to try and understand that, because I thought roughly speaking on your freeholds, including the cost of the freehold, you were looking at probably something around 2-2.5 million per site, and leaseholds I must admit I always thought was circa 800,000 or so.

John Beaumont – *Matrix Group*

I just wondered if you could perhaps clarify that; how you get to your million Pound average. Obviously some of my numbers must be slightly wrong. Secondly, I notice obviously you say in the statement that SCPD sales were £7 million in the year. I was just wondering what sort of profits or maybe loss was associated with that.

Adam Fowle

On new-builds I think it is true that in the past when we built a Suburban pub it cost somewhere between £2 and 3 million, depending where it was. Going forward, where we're taking retail park leases, the capital cost is much lower. What we are seeing though is where we're buying solo pubs off other operators or distressed pubs; that those are costing a lot less than they used to. That is what is dragging the average down.

Erik Castenskiold

On the SCPD it is 7 million of sales. We had already announced the 2 million of loss, which was at the half year. Those two are directly relating to each other.

Operator

[No further questions].

Adam Fowle

Thanks everyone for listening in on the call. This is a strong set of results from M&B and I think it highlights well a) the strategy is being delivered and b) that strategy is working for us. Thank you very much, and if you have got any further questions, do give Erik or myself a call. Thank you and goodbye.
