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Mitchells & Butlers plc

Disposal of 333 Non-Core Pubs for £373m

Corporate Participants

Adam Fowle

Mitchells & Butlers – Chief Executive

Erik Castenskiold

Mitchells & Butlers – Director of Corporate Affairs

Call Participants

Lena Thakker

Bank of America

Tim Barrett

JP Morgan Cazenove

James Ainley

Citi

Richard Taylor

Liberum Capital

Paul Hickman

KBC Peel Hunt

Julian Easthope

Barclays Capital

Simon French
Panmure Gordon

Questions and Answers

Operator

Your first question comes from Lena Thakker from Bank of America. Please ask your question.

Lena Thakker
I've got three questions, maybe if I go one at a time. Firstly the net book value you tell us is 437 million now; can you tell us what that number was in 2007, i.e. how much of these pubs have been written down over the last two to three years?

Adam Fowle
Lena, we haven't got that number to hand. I will get back to you on that one.

Lena Thakker
Then if we could run through the interest costs that will saved, so am I right in thinking there will be no more interest to pay on the unsecured facility, but there is a 5 million fee there?

Erik Castenskiold
That's correct, so in essence what we are saying we would do is not pay down the securitisation bonds to reduce down the drawings on the unsecured facility, and there's an actual inefficiency of retaining an unsecured facility, which has fees associated, mainly commitment fees, which is basically that £5 million that you mentioned.

Lena Thakker

Essentially we'll be going from around 15 million of interest costs on that loan to 5, and I guess the cash pile of almost 300 will earn minimal interest at 1% or something around there; is that correct?

Adam Fowle

That's broadly right.

Lena Thakker

One final one; can you tell us the value of the short leasehold pubs in the books and also what they were sold for please?

Adam Fowle

I can't tell you the value of the short leasehold pubs in the books, but I can probably get back to you on that. The deal was done as an EBITDA multiple deal, so in the round, that's how it was looked at.

Lena Thakker

And the EBITDA multiple on those short leasehold pubs was obviously much lower than on the others?

Adam Fowle

Yes, pick a number, Lena. Our working assumption was about 4 times. There was a blend in there of some High Street pubs and some late night venues; put them together and you get to about 4 times.

Operator

Your next question comes from Tim Barrett from JP Morgan Cazenove. Please ask your question.

Tim Barrett

Just a question on the proceeds and how quickly you think you can reinvest them. You specifically mentioned 160 conversions, but I'm guessing that's only going to cost a maximum of 40 million, so can you give us an idea of what the priorities are for the rest and indeed whether the Board looks at anything more immediate, like a return of cash?

Adam Fowle

On the conversions, Tim, you're right about the 160 number. It's probably going to be about 50 this year leaving about 100, 110 next year, so I think it's fair to assume that the 110 will cost between 40-45 million, something like that. In terms of how we use the remaining proceeds, there are a series of decisions the Board's got to make over the coming months as to how that cash is deployed. Returning to the shareholders would be one of those options, but I think we're being fairly clear that our first and preferred option is to reinvest as much of these proceeds as we can behind what is now our core business, which is an informal dining out business.

Tim Barrett

That would include add-on sites as well, would it?

Adam Fowle

Yes, absolutely.

Tim Barrett

The mechanics of the securitisation on this, presumably you're swapping pubs around; how many will be left outside of security net following the deal?

Erik Castenskiold

Tim, we haven't defined exactly the extent to which we would extract the proceeds. We would definitely extract a significant proportion of those proceeds. It may be half of the pubs outside the securitisation which is the Whitbread pubs in essence that we use to extract some of that cash, but that's something that we will review over the coming months depending on the investments that we make. Obviously it's probably more advantageous to have cash outside the securitisations, particularly for, let's say, newbuild sites or sites which don't have a profitability already that we can either build the profitability or increase the profitability using our brands to get those returns up. It's probably advantageous to have the cash outside, but we may use a balance of cash outside and a little bit of cash inside the securitisation.

Operator

Your next question comes from James Ainley from Citi. Please ask your question.

James Ainley

Could you give us a little bit more colour in terms of how your thinking is developing for reinvesting this cash, the types of opportunities you're looking at, be it single sites, small groups or even additional brands and then following on from that, the second part of my question is can you talk about prices and availability for those types of sites in the current market?

Adam Fowle

Let me start with the last question first, James, and let me wind the clock back a bit. We said in January and March that we were going to focus initially on conversions and 160 conversions over 18 months or so is a lot to manage. We are building a pipeline of solus site and little group acquisitions, but we're still in that process and we've said that will take some time to get going. We're not expecting a sudden burst of solus sites to be announced, let's be clear about that, but there will be opportunities that come along.

As to are we going to buy another brand or anything like that, I think what we've got now is the financial flexibility to allow us to examine all the opportunities that may be out there now or at some point in the future, and allow us to make rational decisions based on the return profile and we'll just leave it at that. We don't want to count anything out; we've just got ourselves some flexibility to move now.

Operator

Your next question comes from Richard Taylor from Liberum Capital. Please ask your question.

Richard Taylor

A couple of questions please. The first one, on the pubs that you sold, can you give us an idea of what sort of overhead that you saw with those pubs, if you can give your overall overheads that you've announced the strategic review, how much of that is sold with the pubs? The second question is you said you would like to improve net operating margins by 200-300 basis points; does this transaction alter your ability to do that on the core estate?

Adam Fowle

There are about £4 million of overhead that goes with this. There is another 2 million that will come out as a direct consequence of it, so that kicks that process off and no, we don't expect this to materially change our ability to deliver between 200-300 basis points on the net margin since the start of this year, end of last year.

Operator

Your next question comes from Paul Hickman from KBC Peel Hunt. Please ask your question.

Paul Hickman

I've got two questions following Lena's question; I wondered if there were any other fees that we ought to be aware of, particularly in terms of the deal itself, the cash consideration of 373 million; are there any fees that Mitchells would be liable for that effectively reduce of that to a net figure. Secondly, a couple of people have asked in terms of the redeployment of cash; I wonder if you could sum up for us any change in your guidance, a change in your attitude compared to previous disposal in terms of the intended rate of conversion and/or site acquisitions.

Adam Fowle

In the round across all of these three transactions, we expect the fees to be about 1%. In terms of the redeployment question, I don't think anything's changed from what we've said before. the only thing that has, I suppose, changed is that we've arrived at the end of this disposal process sooner than we had expected and therefore that's going to obviously enable us to concentrate sooner than we had expected on how we redeploy it in a value creative way.

Paul Hickman

Could you define that a bit more or quantify it in terms of time?

Adam Fowle

It doesn't change at all the speed of the conversion programme, because that's going as fast as it practically can. It doesn't change at all the solus site acquisition process; because that's a hopper that takes six to nine months a year to really start pulling sites through. What it would speed up is if there were any packages of pubs or sites out there that we could apply our brands to that were available or become available. It just speeds up that process, because clearly we now have the cash available to do transactions, whereas before it might have been more difficult, so that's the part that it speeds up.

Operator

Your next question comes from Julian Easthope from Barclays Capital. Please ask your question.

Julian Easthope

I've got three questions as well. In terms of, first of all, starting looking at the margins and your 200-300 basis points as mentioned earlier, were these pubs on materially different margins from the overall estate and will they make a difference to the overall starting points of the margins of the group that you start with? Second point, now that presumably your net debt to EBITDA has gone below five times, your dividend payment, I presume now, is a dead cert for the full year. The third point is on the facility fee; given you've actually got 290 million of cash, the facility, I think, goes on for another couple of years; it's aggressive to keep that with the 5 million cost, bearing in mind there doesn't seem to be much availability out there at the current time.

Adam Fowle

On margins, historically this business, the disposal business has made higher margins than the retained business, because it's a groups-led business, it's predominantly group. In terms of the dividend dead cert, that's a decision the Board will make at the end of the financial year, but clearly one of the conditions we set which was sound financial platform has been met. The only final condition is a feeling of certainty and robustness about the outlook, but that's a decision the Board can come to in due course. I'm going to let Erik answer the facility theme.

Erik Castenskiold

On the facility, I think what we're doing is allowing ourselves the flexibility to have the funds in overall available to reinvest as we see opportunities arise and value opportunities as they come. If that was to change, obviously we'll take a view on the interest cost, as you note, on the facility, but I think at the moment we see greater opportunities in the medium term, so that's why we're leaving it as is.

Julian Easthope

But if you cancelled it now, would you still have to pay the fees anyway?

Erik Castenskiold

Yes.

Julian Easthope

Just coming back on the margin question, the 200-300 basis points from basically last year's figures, you're not going to change that even though the underlying number is now going to be below what it was, because particularly the lodges I presume make quite a difference to the underlying margins.

Adam Fowle

The lodges obviously had a very high margin, but had a relatively low contribution, so we're still happy with the underlying margin target we left ourselves with.

Operator

Your next question comes from Simon French from Panmure Gordon. Please ask your question.

Simon French

Sorry to harp on about the margins, but just looking through the release it looks like the retained business generated a margin of 15% last year; should we be targeting 200-300 basis points on that going forward?

Adam Fowle

Yes, you should.

Simon French

Then just on the facility question, can you tell us what size the facility is at the moment please?

Adam Fowle

We draw at about £280 million on the unsecured facility at the moment.

Simon French

Just one final one, you've obviously sold about 60-70 lease on sites, what percentage of the core estate is leasehold?

Adam Fowle

By number of outlets I think it is about a bit more than 90%. I think we're at about 10-12% of the outlets, I'm guessing, of now leasehold as a result. It's about 10% of the outlets left are leasehold.

Simon French

And then just one cheeky if I may at the end. Have you got a start date yet for your new Finance Director?

Adam Fowle

Tim will be joining us at some point in the autumn. As soon as we have a start date we will inform the market.

Operator

Chad Slick, Deutsche Bank.

Chad Slick – *Deutsche Bank*

Good morning. Could you just clarify the number of pubs of this 330 which are currently part of the securitisation today?

Erik Castenskiold

It is pretty much of all them that is part of the securitisation.

Operator

Ian Rennardson, Bank of America.

Ian Rennardson – *Bank of America*

Morning guys. Most of mine have been answered, but I am banging on again about the acquisitions or how you intend to spend this money. This deal today is relatively dilutive to earnings. I am just wondering why now? Are you expecting the market to get worse for disposals and therefore you thought this was the best you could? Why didn't you hang on?

Adam Fowle

Two reasons, we have a perspective about the late night youth drinking marker, both as it were a view on the levels of disposable income youth is going to have going forward as a result of high youth unemployment, and of course about the relentless duty rises that are coming through there. We have a perspective. That needs to be set against our perspective about the future growth prospects of our food business. Yes we are changing horses as it were, but we think this is a good time to change horse. The other key thing here that is very important, this is a single deal that has dealt with all of the businesses that we have in this space. That is an opportunity that has to be taken, so that is why we have done it now.

Operator

James Ainley, Citi.

James Ainley – *Citi*

Hi, I just a have a follow up question please. Clearly you highlighted that the 1% break fee. Have you spoken to your big shareholders and are you comfortable you will get shareholder approval for this deal?

Adam Fowle

Obviously our largest shareholder has a representative on the Board, so they have been aware of the process we have gone through. We are comfortable that they support this deal.

Operator

Hugh-Guy Lorriman, Seymour Pierce.

Hugh-Guy Lorriman – *Seymour Pierce*

Good morning Adam and Erik. I was looking at Appendix 1 on page 6, [unclear] financial information. Could you clarify on item two the summary of financial information on the core business? Is that the whole remaining business including head office that we're looking at, the EBITDA and your total profit, or is there some other factor?

Adam Fowle

That is the whole core business that is left after all of the disposals.

Hugh-Guy Lorriman – *Seymour Pierce*

As though they were never part of the business; that is what it looked like.

Adam Fowle

That is what it looks like standalone.

Hugh-Guy Lorriman – *Seymour Pierce*

I was just looking therefore the '09 figures versus '08, and I noticed that the revenue for that core is up 5%, but the EBITDA is down 6 and the margin is down 2, 2.5% about. Can you give us some flavour on the dynamics behind that in what is the best part of your business for that period?

Adam Fowle

That was the year, particularly the first half of that year, when we had the combined impacts of massive energy inflation - I think that was about £30 million of energy cost - and food price inflation at the same time. Those two things came together and hit the net margin.

Erik Castenskiold
Hugh the two, food and energy together was the £30 million which in effect that hit the majority of that.

Hugh-Guy Lorriman – *Seymour Pierce*
It is entirely cost led?

Adam Fowle
Yes.

Hugh-Guy Lorriman – *Seymour Pierce*
The only other thing I had was really on Lena's question at the beginning on net book value. Can you give us an indication at all that that particular portfolio would have been hit by somewhere towards the average of the book value decrease that we saw '09 versus '08. I can't remember what it was, was it 10%. It just seems a really good question to clarify on.

Adam Fowle
I think the way to look at this is we did take book values down over the last two years by 9%. But clearly these pubs have seen their EBITDA drop by close to 20, 25% over the last three years. They have had a bigger impact in terms of their loss against book, by all the reduction against book value.

Hugh-Guy Lorriman – *Seymour Pierce*
It will be closer to that 20, 25%.

Adam Fowle

Yes.

Operator

Lena Thakker, Bank of America.

Lena Thakker – *Bank of America*

Hi guys, sorry just a couple of follow ups. In terms of the £10 million which you have agreed to give to Stonegate; why have you had to agree to this? In terms of accounting, I guess you will just be booking the EBITDA up to mid-November and then stripping the 10 million out of cash. Is that right?

Adam Fowle

Effectively yes. Why have we had to do it? We're clearly selling the business to a business that is starting up, and this was the best way to get between exchange and completion whilst we wait for shareholder consent.

Erik Castenskiold

It is little bit like having a deferred consideration, which is delayed for the period till completion. The deal is done but we're just delaying that receipt.

Lena Thakker – *Bank of America*

Then just another question on Appendix 1. When you look at those numbers on the non –core pubs, it looks like margins have fallen from around 15.6-14.6% for the non-core between 2009 and 2010. I am just wondering if there is some phasing in there, i.e. is that 14.6%, what was that last year and has there actually been a fall in margin this year on the non-core stuff or is that just the seasonality?

Adam Fowle

On the non-core or the core?

Lena Thakker – *Bank of America*

The non-core.

Adam Fowle

The non-core, yes. The margin has continued to decline, because it is very drinks led. The core has grown.

Lena Thakker – *Bank of America*

That is not just the fact that we're not including the summer in the 2010 numbers there?

Adam Fowle

The 2010 is a 52 week number, so it includes last summer. It hasn't got the World Cup in it. It is a comparable period of time to 2009. They're both 52 week numbers.

Operator

Ben O'Toole, HSBC.

Ben O'Toole – *HSBC*

Good morning guys. I take your point on conversions of sites having a priority, but when you do talk about acquisitions, can you just give us some thoughts on what size of entity or estate you might be looking to, or you could digest? Can you just clarify that you are or not having discussions with anybody at the moment?

Adam Fowle

I can deal with the last one first Ben. We're not going to talk about any conversations we have had with anyone, until there is something to report to the market. In terms of size, there is a pool of capital there that can be deployed. This business has historically in the recent past swallowed acquisitions of up to 250 pubs without too much difficulty at all. I don't think size in relation to that pool of capital is an issue.

Ben O'Toole – *HSBC*
Are you aware of any vendors at the moment looking to exit any particular assets?

Adam Fowle
Again we can't comment on anything like that. The market is where the market is at the moment.

Ben O'Toole – *HSBC*
I understand. You are willing to consider leasehold assets presumably?

Adam Fowle
We have said when we talking about our solus site process that many of the sites we had opened for the likes of Harvester and Toby would be shortly sold assets.

Operator
Richard Taylor, Liberum Capital.

Richard Taylor – *Liberum Capital*
Yes just a follow up again on the disposal pubs. If they predominantly come from the securitisation, are you forced to put an incumbent pub in there, or could you potentially do nothing and leave all the incumbent pubs outside of the securitisation?

Erik Castenskiold
We can't keep all the proceeds within the securitisation just as cash, because we will trip ourselves up on the covenants just because we have swapped EBITDA for cash. To some extent we need to extract some of the cash proceeds out and swap that in for EBITDA. There are some assets, in effect we need to put…I think you're alluding to, that could be free hold and leasehold, there are some covenant constraints on the numbers of leaseholds but we have got the flexibility for that if necessary. Yes so 400 leaseholds, we have the maximum number of leaseholds that we can take in that respect. Was that you were asking?

Richard Taylor – *Liberum Capital*

It is really just a sense as to what is going to remain outside of the securitisation as a follow up to Tim's question earlier on. You have no short term debt and you have a significant number of assets, particularly the Whitbread pubs which are an incumbent, so just what was going to be left outside the securitisation post this transaction and post moving the pubs potentially into the securitisation?

Erik Castenskiold

I think a simple way of looking at it is we have got £700 million approximately Whitbread assets outside the securitisation. There is an extent to which we can use a number of those. We could use, I suppose up to, in effect nearly £500 million if we wanted to. We don't have to do that in totality. There is always going to be a number of Whitbread assets outside, but we will look to move some of those in as well.

Operator

Gareth Dunsmore, Paternoster.

Gareth Dunsmore – *Paternoster*

Good morning gentlemen. I am just wondering from the debt side, have you had any conversations with the rating agencies with regards to their views on your securitisation following these disposals?

Erik Castenskiold

It is not a step which is necessary in the process that we have gone to date. Obviously the rating agencies review us on a regular basis and I am sure they will have seen our announcement. But overall I see that that is probably medium term credit positive for the securitisation. We have sold a lot of leasehold pubs out of the securitisation. Obviously there is a question of which assets we bring into the securitisation. For the Group as a whole this will be bringing in better long term value creative assets and growth assets, which will as I say, be in credit positive to the securitisation in the medium term.

Gareth Dunsmore – *Paternoster*

Would you confirm then that your policies to maintain the current rating securitisation? Would you allow them to drift further downwards if that was in the interest of shareholders?

Erik Castenskiold
Ultimately there isn't a strategy to say that we have to keep the ratings at a certain level. However though our strategy is to increase EBITDA and create value which will in essence increase the ratings of the business. Yes our strategy is to increase that rating; it is not to look to reduce the bond ratings at all.

Operator
Julian Easthorpe, Barclays Capital.

Julian Easthorpe – *Barclays Capital*
Just a couple of questions if I may. Just in terms of the numbers, could you say how much your lease costs actually declined following this transaction? Secondly if you're transferring all assets now into the securitisation outside of the head office, does that have any implications for the pension fund at all, following the refinancing you announced a couple of months ago.

Adam Fowle
While Erik works out the lease cost, the transaction has no impact on the deal that we announced earlier on this year with the pension fund, so that stays as it is.

Erik Castenskiold
On the rental cost, it is broadly around £15 million of rent which is being included within all the disposal pubs, not just the ones that were announced; Hollywood Bowl and the Lodges included as well.

Operator
Guillaume Langellier, Aviva.

Guillaume Langellier – *Aviva*

Hi there, just a quick question. Looking at the securitisation on the permitted disposals; I was just looking at one of the covenants that basically say that you cannot dispose of mortgage properties that represent more than 10% of your securitisation EBITDA. It seems you have got properties that – given the size of the disposal I was wondering whether you are complying with that clause or not? The second question is just about valuation. Obviously I appreciate that the 7.2 BDA multiple includes some of the properties under short leasehold, but I was just wondering what it means for the value of the free hold pubs and the Group in general going forward. Maybe if you could give us comments from the valuers would be appreciated.

Adam Fowle

On the securitisation yes, there is as it were a limitation of 10% per annum, but we have received consent from the Securitisation Trustee to enact this transaction. That is not an issue. In terms of the valuation going forward, clearly the fact that the EBITDA in these pubs has reduced a quarter of the last three years affects the value. The core retained business has actually seen EBITDA broadly flat starting to grow again. We're not expecting that to negatively impact values there.

Operator

[No further questions].

Adam Fowle

Thanks everyone. From our perspective or from my perspective we see this as a good price and a very positive deal, because in one transaction we have released our non-core or tail of pubs, so we're very pleased about that. This completes the disposal phase of our strategy. We have realised £500 million and it leaves M&B in a very good place to start looking more proactively to the future and investing where we said we would in our strategy around informal dining-out where we have got some of the most powerful brands in the market. We think this is a pivotal moment in the future shape of M&B. Thank you very much and Erik and I will take any more questions you have outside the meeting.
