Mitchells & Butlers

Mitchells & Butlers Half-Year Results 2012
Friday 18 May 2012

Q&A Session

Question 1
Jamie Rollo, Morgan Stanley
Morning, Jamie Rollo from Morgan Stanley. Three questions please. On the number of new sites and conversions of 55 this year, I think that implies there about 13 new sites in the second half of the year if my maths is right. So I think you did 42 both conversions and new sites in H1. Why such a big slow down? And could you discuss the pipeline please?

Secondly in terms of the cash you hold at the PLC level, the £200 million, you said you are not likely to do any more package deals. So what are the plans for that cash going forwards?

And then finally, if we look at the exceptional costs on the systems and the IT, what has led you to exceptionalise what appear to be normal costs of business? Why wouldn't you just expense the costs over time and going forwards? Thanks.

Answer : Tim Jones, Finance Director
Jamie. New sites, it will lead to an imbalance if you like H1 and H2. I mean a lot of those 42 have only just opened, less than one period by the half year. So it is really a function of that cut off rather than anything else. Basically we plan to maintain our new site acquisition programme at around 50-55 sites a year. That is what we did last year, that is what we did this year. And the total will come off as the conversions come out of that. So I wouldn't call it a slowdown in activity, what I would call it is a completion of another activity that existed alongside that if you like. If you look at next year, I think 55 is probably a good number as well.

PLC cash, £200 million. So this is basically the proceeds from the Stonegate transaction which we extracted from the securitisation. You can see the benefit of that coming through in our interest line as we paid down non secured facilities. So what do we do with that? We could pass it to stakeholders, and I say stakeholders because a substantial proportion would have to go into the pension fund if we were to contemplate passing this out to shareholders as a special dividend. That is theoretically one course of action. How much we could do - I think if we pass too much out we will have to put a facility in place to deal with our working capital headroom and that would be very expensive with arrangement fees and utility fees. So I think the amount you could do without triggering all those costs would probably be half of it, maybe just over half of it, and that would have to be split between equity and pension in the same proportions. That is one potential use. I am not sure quite what it achieves and it would be a one off.

I suppose option number two is you start paying dividends now, when you can't afford them, which I don't think is a very sensible thing to do, so we are not really looking to that. Third option would be I suppose to buy back bonds from the securitisation, to cancel bonds in the securitisation. We look at that periodically. Frankly the return on that just isn't there partly because of the swaps we would have to close out on the floating rate notes, and on the fixed rate notes I think in such an illiquid market we would end up bidding up the price that we are buying those back at, so the returns just wouldn't be there. And there are other people in our sector that set out to do that as I am sure you are aware and not really achieved it because they found the returns not there.

Fourth option is to spend it. And I think we will not do… M&A and package deals aren't on the agenda for us in the very short term, I think our focus is on getting our business in the right shape as Bob as talked about and I think it would be brave of us to take in a large pub estate and look to bolt that into that whilst we are still rolling out own infrastructure and our own environment. So that is not there in the immediate term. But I think going forward we might do that, you know once we have worked on Ha Ha and completed our business transformation. I think if there was a sizeable pub estate out there where we didn't feel we were buying other people's problems and a very long tail, then that is something we would seriously consider doing as potential use.

And I guess the fifth option is you bide time, you leave it there for now, you have got a cheap form of debt from the securitisation and you attain a bit of flexibility in the current climate. By default that is where we are at the moment. I have to say I don't see a compelling reason to select any one of the four options I headed out as we sit here today.

Answer : Bob Ivell, Executive Chairman
If you take something like Ha Ha, I mean we paid a premium for the brand. As always with a package you get a selection of very good sites, but you also get a selection of not so good sites. And if you look around the marketplace, a lot of the smaller packages in particular have got real mixed bag of sites. So you know, we have got strong brands, we talked about things like Harvester and Browns, which we have got plenty of growth potential still in. So our view is certainly at this point in time is to focus on growing those and getting quality sites in there. But you know, never say never because who knows.

Further answer : Tim Jones, Finance Director
I am not sure exactly which exceptionals… there is a bid defence cost of £6 million in there and then there is £14 million around this business transformation. Every business is always doing some pruning and revising and you know refining of its structure. But what I think we are doing at the moment is out of all proportion to what I would consider a normal level of restructuring activity. And you can see that by the scale of the costs and you can see that by the scale of the payback, of the £10 million, that we have got coming through going forward. I think were we to slam that into our normal operating margin, we would then have to help you to pull it out when we are looking at the sources of change going on in there anyway. So that is really what our central column is there to do, to give you, I think, clear visibility of what is there. If you feel you want to add it into normal position, that is very easy for you to do that. We think the scale and nature of it is a one off transformational programme that is worthy of if you like disclosing separately.

Question 2
James Ainley, Citi
Thanks, it's James Ainley from Citi. Two kind of related questions. What would your returns be if you subtracted a proper allowance for depreciation? And do you believe that 17% return truly covers your cost of capital after you allow for depreciation and tax? And I guess particularly when I think about the returns on freehold sites, why do them because they appear to be pretty low returns?

And then following on from that, what are your plans in terms of expansionary capex for FY 13 and the split between freehold and leasehold please?

Answer : Tim Jones, Finance Director
In terms of taking that EBITDA return and turning it into an EBIT return, I think was your question James, probably take 5% off those returns, 5% or 6% depending on whether it was a conversion or freehold acquisition. It would be less for a freehold acquisition. The 17% as a composite is below you know our aspirational return as I said. I think you probably need to split it between freehold and leasehold. The sort of composite leasehold return is up around about 20% and I think we are creating value at that level. Our freehold return is 14%. Obviously there is no capital growth or anything built into that, that is purely a return on the investment. I think they are good quality sites. I think in this challenging environment, some of them aren't trading as well as eventually we will be able to get them to. But we are pretty comfortable that we will generate value going forward. And if we do see the right freeholds to buy going forward then we will buy them on a single site basis.

I mean going forward, I talked about 50-55 new acquisition sites, we are keen that freehold remains, you know, an element of our expansion alongside the leasehold. Leasehold is, if you like, is somewhat easier to achieve. I think there is a more liquid market out there for leasehold sites, particularly in retail and leisure parks. We are still finding a number of sites that we are very interested in. I think buying freeholds is tougher and with some of the prices being paid on deals that you see in the public domain are fairly high in many cases. So it is perhaps a bit more illiquid to achieve freehold growth, but a quarter to a third of those sites being freehold would be about where ideally I would like it to be. In terms of pounds that would probably be a half and a half because obviously you pay more for a freehold than the average fit out cost for a leasehold.

Further question : James Ainley, Citi
What would be the expansionary costs for next year?

Further answer : Tim Jones, Finance Director
Well that 55 sites, I mean that blend of what I told you would be £55-60 million.

Answer : Bob Ivell, Executive Chairman
I think the other point to make, I mean to put it in perspective as well, is I mean, a lot of these sites have quite recently opened and I think unlike some of... I mean depending on which marketplaces you were in, but a lot of these sites.. so our Vintage Inns, PCDG-type businesses, are actually much longer life cycles and take a longer burn. So they tend to build by reputation so they can take 12-18 months to build up before you actually, you see... I mean you know, the history I mean obviously for me with Chef & Brewer, they were very much in that sort of marketplace. And what you found was the lifecycle was a lot... And I think one of the things we sort of anticipate or don't anticipate as well, because you know across the spectrum of brands we have got is what the different lifecycles are. A Harvester by

and large tends to go in and because of its brand awareness and because of the marketplace it is in, tends to go in at a pretty high level.

But I mean we are not in the fashion market particularly, where you know you get a lot of these places that go up and come back down again. Ours tend to be much more about building reputations. But, and you know, we opened a whole bunch before Christmas, so a lot of these places went you know, had their openings, probably not that well established and then go into a January, February. So I mean I think it is still very early days on some of those. And I think that obviously what you get as well with some of these brands is that you need to… a lot of costs go in up front. So again it makes the returns look not always quite as good in the early days. But I think we are pretty confident.

The other thing we have done is we have been much more robust about, as I said... I mean if you remember, I mean M&B went from one, doing one, acquisition to 50 very quickly and they moved very fast. And to be frank I think there were some lessons learnt in selections of sites. I mean give you an example, we moved into retail leisure parks over… with Harvester particularly, but with Toby as well. And I think one of the learnings which to me to be frank would be quite obvious, is that, and we know that from things like Frankie & Benny's and all other people in those leisure parks, is you really want to be in retail leisure parks because you have then got trade and traffic going through all day, so you are sweating your asset from the morning right through to the evening. One of two of the early ones were done in retail parks without leisure so there is great throughput in the day, but not necessarily in the evening. So there are some lessons. We have put a lot more rigour into site selection as well and we are pretty confident with what we are buying now.

And I think the other bit in the returns, again which is why Tim stripped it out, is I think you remember at the November Results I talked about, there was this… sort of… everything had to fit in a box as I say, so it had to be a brand. So you couldn't have, and I think I always give the example of The Rocket which Tim says I stole off him. But The Rocket is opposite us, virtually, in Euston Road, is a pub that made its, it is a non branded pub, it makes about £350,000 a year and I think when I just came on board, we were about to spend £650,000 on it to turn it into a Nicholson's. Well two things, that is not a Nicolson market. So what you would have been doing was spending £650,000 to lose the trade that was there and try to build a new trade. And of course you mightn't even have got up to the trade it was doing. So actually we spend £80,000 on it, tidied it up and it is now making over £425,000 this year. So to a degree we have stopped some of that, it has got to be a Nicolson's, it has got to be a Castle, it has got to be that. You can have good pubs and it does good food as well. So we have a selection at the bottom that don't fit into boxes but that doesn't matter, as long as we make money out of them, we don't mind.

Question 3
Geof Collyer, Deutsche Bank
Geof Collyer from Deutsche. Two questions. How long do you think it is going to take you to complete the WOW rollout?

And secondly, is the focus on the four main brands just a leasehold focus or is that where you are really looking to expand? And if that is the case, how do you keep the people who are in charge of the other three-quarters of the estate sort of focused on just getting on with the day job as it were rather than having a bit of extra sex through expanding the size of the different brand formats?

Answer : Bob Ivell, Executive Chairman
Okay. I mean the WOW work that we are doing is probably going to take, we reckon a year, but again the danger with all these things is you set targets and time rather than actual getting the quality and getting the things happening and getting it right. And it is quite interesting - culturally it is already spreading. We are finding managers saying, we want to do this and actually learning. And look it ain't rocket science what we are doing is taking them from out of the back of the office filling in their forms and sitting there and saying, right we are taking some of that away from you, we are making sure we control what comes down to the pubs. We want you to spend time training your staff, talking to your customers, just doing all the basics and training staff as well. And then on top of that, as I have said, I mean if you don't give people the tools, if you don't give them crockery and cutlery to do it, it is not surprising you turn people away. And getting staff in at the right time. So some of that almost is happening by osmosis, but the real training and the real development is probably going to take twelve months.

So the second point was? Sorry.

Further question : Geof Collyer, Deutsche Bank
The second point is if you are focusing on new build programmes just on those four brands, how do you keep the rest of the business..?

Answer : Bob Ivell, Executive Chairman
We are not just focusing on the four. They were just, I mean we would be here all day if I took you through every one of our concepts of brands. They are just four examples of where we are. We are taking sites on merit. We are looking for quality sites and our team are out there looking right across the spectrum. So you know at the end of the day we are saying to our operators we have got all the formats that we want to grow, we will put our money where we get the best bang for our buck. It is quite as simple as that. So we are looking, and we are buying things from PCDG and Vintage and some of the others as well. We are not necessarily perhaps expanding Sizzling Pubs or Ember at this point in time. But then we are refurbishing some of those and getting those right and again I think that was an area, to be frank, I think the business pushed too hard on the food side of the business and we lost some liquor trade because of that. And what we are seeing is we segmented those estates now and, again, very early work which I didn't talk about today, but we are now seeing some really good results coming through. I mean for example Ember Inns didn't let families in. Why? And what have we done, we have let families in and lo and behold we are doing very well with it. And you know Hungry Horse and all our competitors were all letting them in, so why wouldn't we? So I don't think we have got any sort of morale issues from that perspective. And it just encourages people to make sure they get really good returns which is hopefully a self fulfilling prophecy.

Question 4
Tim Barrett, Nomura
Tim Barrett from Nomura. Two quick things. You talked about investing in labour, but in practical terms what has that meant for labour/sales ratio and how temporary should the uplift be in your plans?

And then secondly 50-55 sites is about double the rate of some of your competitors. How do you manage such a rapid rollout?

Answer : Bob Ivell, Executive Chairman
Well I think investment in labour is as much… I think twofold, one is training; and again to be frank, training hours were built into... I mean I think again most of you were probably around in November when we talked about our PPS system which is our wages and rota-ing system which was used historically on an hours restriction which said, if you are X House, you have so many hours because that is what your turnover is. And that is what you are restricted to. They put the managers on the hours and they put training in there. Now what inevitably happened was training didn't happen. I mean, to give you an example, All Bar One had had no wine training in two years. Now, All Bar One is a, what it is is very much a wine driven business. Now you know, there are too many good competitors out there with good operations. If we are not good at what we do and we can't deliver for our customer in talking to them about wine then we fall behind. So.. and that hours system was used as a big stick. So what would happen is on a Monday, a manager would work on the basis that, I don't know, last week you did 100 covers on a Monday night so he would staff up for 100 covers and he would do 30 because this business tends to do that. So he has just now wasted a number of hours according to the system. So what would happen, as that went through the week by the time Friday and Saturday where our peak trading times came, they hadn't got enough hours, they hadn't got enough staff. And they wouldn't put more on. They wouldn't take the risk and the reason they wouldn't... because if they went over on the hours they got a letter saying, "Do that one more time and you will get a warning". "Do it one more time and you will get fired". So even if you took another five grand this week, if you still went over on your hours, you still got a letter which is madness.

Now it is actually a great tool, it is a tool that actually McDonalds use. If you use it for what it is supposed to do, is to help you actually try and rota your staff. So to a degree, there has been a bit of doing that, making sure we have got weekend trade. And you can tell by all our, sort of, measures of customer complaints, all the measures we have, clearly service was showing this wasn't good enough, particularly at weekends. And so we put more staff in there, we are training the staff so they become more efficient. I mean you know the stuff that those people were talking about on that video was common sense isn't it. If you train them, you make them enjoy working more, they are going to be more efficient, they are going to sell more and so your efficiency... and what was interesting if you noticed on the chart, sales had grown, but profit was growing at a faster rate in the trial houses which shows a) when we have got staff, we are actually selling things. So therefore we are taking more money and in this business the more it ratches up, the more it drops to the bottom line. So again it is pretty straightforward stuff there.

So that investment we think has probably peaked, because there has been an awful lot of training suddenly gone into the houses because again people have not been frightened to do their training. And what we have done is, managers are not treated as hours, they are treated as people running the businesses and allowed to do that. Was there another point?

Further question : Tim Barrett, Nomura
Managing the overall roll out.

Answer : Bob Ivell, Executive Chairman
That's not difficult once you get there. You know 50 for a business our size is not particularly difficult. I mean you get your peaks and troughs. We have got a very, very dedicated team to build these places, and clearly you do get... I mean we had I think a number of openings before Christmas, quite a lot wasn't it, something like 22 or something, so you do get a peak and quite a lot of those were Harvesters. So the

Harvester team were, you know, pretty busy. But 50 for a business our size shouldn't be a problem once you have got it geared up.

Question 5
Richard Taylor, Barclays
Morning Richard Taylor from Barclays. Just one question on the pension. You mentioned in the Financial Review that if real gilt yields stay the same there will be upward pressure. Can you give us idea as to the materiality of that?

Answer : Tim Jones, Finance Director
Yeah I can give you a scoping. I mean gilt yields are negative at the moment. We give a sensitivity of 0.1% worth, I think it is £27 million on the value of our liabilities. That's an IAS19 sensitivity, but it probably holds pretty well for an actuarial valuation as well. So, you know, if you look back, I think March 2010 when the last triennial was done, and you can check this, but I suspect gilt yields were plus 1 maybe, plus 1.1, something like that. So that will give you the delta of the possible movement. Obviously I would stress there is a whole other number of assumptions that go into that process, it is not just about gilt yields, it is about mortality, it is about asset returns etc. etc. So just treat it with a bit of care looking at that one in isolation. But I think if you look how real gilt yields have moved and combine it with that sensitivity that will give you a flavour.

Question 6
Lena Thakkar, HSBC
Morning, Lena Thakkar from HSBC. Just one on the price rises. Obviously the price rises this half have been quite significant and also the last couple of years. And above some of your peers. I am just wondering how sustainable this approach is? And is there is risk of driving away the value seekers from some of your brands?

Answer : Bob Ivell, Executive Chairman
Well I don't think we actually are above a lot of our peers, we obviously constantly do surveys and actually if anything… something we have just checked very recently... and we are actually have a gap between us and quite a lot of our competitors. So I am not saying we are massively below, but actually we are below most of our competitors in a number of areas. I mean food menus are a bit more difficult because it depends on the market segment you are in and the type of offer you have. But again, I think you will find some of our peers have actually raised their prices more than we have. Which again, clearly from our perspective, where we sit…. I mean we have some premium offers in premium markets with premium sites. We are maybe not premium priced enough, but one would treat that with caution in this marketplace because of where we are. But I wouldn't say… our view is we are not actually above the market. And to be frank, if you look at some of the competitors and we were talking about some of the pubs, from one of our competitors with a couple of guys earlier on. And when you compare the quality of the space, ours is clearly a lot better. Tim, I don't know if you want to add to that?

Answer : Tim Jones, Finance Director
No I think that's fine.

Question 7
Jeffrey Harwood, Oriel Securities
Jeffrey Harwood from Oriel, two questions. First of all, can you touch upon the differential performance of your brands? Is there anything to highlight there?

And secondly, in terms of your medium term margin aspirations, is there any change there too?

Answer : Bob Ivell, Executive Chairman
As far as brands are concerned, interestingly, our premium end brands by and large are doing extremely well. I mean the Vintages and PCDGs have probably suffered a bit more over April because they are the ones with lots of big gardens and outside eating and clearly as Tim said, April last year was very hot. So the comparison is difficult. Browns is trading very well. All Bar One is trading well. Castle, Nicolson's, our premium pubs particularly in London and cities are doing well. The area probably more under pressure is the value end, which is the sort of Sizzling Pub end because clearly the margins, because it is value, are less and a lot people tend to play in that bottom end of the market because it is less skilled, it is less.. it is easier to do and it tends to be more pre-prepared type food. And there is a lot of discounting goes on there. I do think to a degree, I think as I said earlier on, we have slightly shot ourselves in the foot on our liquor side in some of those brands. A lot of those sites are community type sites and we have sort of… again it is this, sort of, we are going to go for food everywhere and we are going to become restaurants. And the reality is these are not restaurants, these are really good community pubs doing good food at the good value end. And so… and again, it is treating them all the same across the country and the reality is you should segment them as they sit in different market places. So we have been doing that work and as I say we have seen some really good early signs and we are seeing some of that come back. And the family thing I was talking about with Ember and so on. But I think Harvester and stuff… and Toby actually, funnily enough, have been quite lucky with the weather because they like the rain. So Toby had quite a good period so the mid market stuff has been pretty good as well. It has its moments, as Tim said the market is a bit like that at the moment. And of course you have had different bank holidays and Easter being early and all of that throws it out.

Further question : Jeffrey Harwood, Oriel Securities
And the margin target?

Answer : Tim Jones, Finance Director
The target that the Group put out was just over two years ago, two and a half years ago was 17.3% by 2014 or the right side of 17.3%. We were 16.4% last year. I think we still feel that that target is achievable. I think a lot of the work we are doing in the business transformation that Bob has talked about, the £10 million we get from that will help. Duty, we factor in our plans, will continue at 2% above inflation and I think that food inflation, particularly meat might ease a little bit. And energy is, I guess, harder to call. But certainly if we have, by 2014 if we are into a slightly more benign consumer environment, you know I think we could get to that margin target. I think if the economy stays tough and you know getting people to come out stays tough when we may struggle to get that, but it is still realistic I think.

Question 8
Patrick Coffey, Liberum
Morning, Patrick Coffey at Liberum. Just a very quick question on promotions. You mentioned the value focused end, your competitors are kind of focusing on promotions. Can you just give us an idea of what you have done in the last six months with promotions, or kind of year-on-year change and increasing your promotions and discounting? Thanks

Answer : Bob Ivell, Executive Chairman
We have been more selective. I think again one of my observations was early on going through some of our businesses and the amount of things that were going on. And reality is we focused on one or two things. But we have done some of that. We obviously react where we feel there is a local need to but I don't think we have really massively changed our spend particularly. We have been more selective. Again if you were around in November I talked about, you know we put Sizzling Pubs on TV last year, absolutely madness, but so we have taken all that type of stuff out, albeit Harvester is responding. And now we have got… you know we shouldn't underestimate… I ran Beefeater in the 1980s and Beefeater was a 250 brand, it was a very powerful brand and made a lot of money. And we have got Harvester now to 200, so on its own it is stand alone extremely powerful brand and I think sometimes people forget, because it is amalgamated into our business as there are a number of others. So… and what we are trying to do, part of what we are trying to do, with our sort of change in the business is putting the focus and money into making sure we deliver to the customer.

My view has been over the last 40 years, the best form of advertising is word of mouth advertising. You know you have got to build a reputation. The really interesting stuff is the social media stuff, I mean that is a totally new world for restaurant businesses, particularly pubs who have got to take this on because as I said, you only have to have…. You can have 700,000 or a million people listening to conversations about one of your pubs and it can be very powerful if you are trying to attract them and very cost effective of course as well. I mean I seriously do find that we have got 300,000 facebook users in Toby quite staggering because you know by nature I mean Toby Carveries tend to be quite an older profile customer, a bit like me I suppose! But…. and you know maybe they have got more time or something like that, but you wouldn't naturally think they are…. if you are talking about All Bar One or something then I would say yeah, I understand why that is. So it is quite fascinating and again we have got to be really careful we don't have preconceived ideas on that as well because you could come a cropper. So I think that is where we are going to go more and more.

Question 9
James Ainley, Citi
Just a quick follow-up. Given the easing cost pressures and the cost actions you are taking do you think you can hold your second half margins flat year-on-year?

Answer : Tim Jones, Finance Director
Yeah I think we could do that. We are down 0.7% in the first half. I think it will be tough to recover all of that, but I think we could hold the second half flat.

Answer : Bob Ivell, Executive Chairman
Interestingly, one of the things that was sort of… one of the facts on our IT that shouldn't be missed: we have moved our ability to change menus down from six

months to four weeks. So that means we can react to new opportunities on products, but also products that suddenly go up in price and we want to engineer away from those and put new items on. We can do that in four weeks. Now clearly there is cost of printing menus and stuff like that, but that ability to react much quicker is going to be very powerful for us. As you know, the entrepreneur on the street can do that overnight. You know big companies like ours have tended to be quite cumbersome and slow in being able to do that. So you shouldn't underestimate how powerful that will be going forward for us and our ability to flex.

Other questions? Nobody?

Thank you very much. Have a good weekend and go to lots of our pubs.

End