ANALYST PRESENTATION TRANSCRIPT

MITCHELLS AND BUTLERS PLC FULL YEAR RESULTS 2018

22 NOVEMBER 2018

Tim Jones: Thank you very much for coming I'm going to take you through the financial results for the year and I'm going to hand over to Phil as always who will go through some of the operational and strategic highlights. But let me start with a summary of what we think are the main messages from today. It's an encouraging set of results and certainly we feel this builds on a lot of the progress we've had over the past couple of years.

Growth has been sustained and importantly that remains ahead of the market. Overall our profits are marginally down but I think importantly we've shown growth in the second half of £3 million EBIT and that's actually the first time since living wage came in, in April 2016, that we've delivered a half-year growth so we think that's a very important inflection in our performance as we move to stabilise the profit performance of the group.

We've also made a good start to the current year, it's only seven weeks but like-for-like sales are up 2.2% so that gives a solid base to build from. Our environment does remain tough though we've still got our cost headwinds; I'll talk more about those and clearly there's a lot of uncertainty on the macroeconomic environment. But we are gathering momentum and particularly from the second wave of initiatives and Phil will talk quite extensively about those later.

And then lastly we spent a lot of time last year talking about capital allocation, how cash moves around the group. I'll talk in more depth about this later but given the application of the criteria that we specified then we will not be declaring a final dividend for this year.

Getting on to the trading performance you should remember that last year was a 53 week year but what we did disclose to you a year ago was a pro forma 52 week performance so what I'm going to focus on in this presentation is exclusively that 52 week year-on-year comparison when I'm discussing our performance.

Overall sales were up 0.5% as we made some disposals in the previous year if I adjust those out it's about a 2.7% impact of the increase in sales. Our EBIT was down to £303m, that's down 1.6% year-on-year or a £5m decrease; EPS down slightly less at just under a per cent.

Let me look at some of the moving parts within that performance. Of course, sales are important but it's been an unusual year we've had some good news and we've had some bad news, we've had the snow, we've had hot weather, we've had a successful football team none of which we're particularly used to. What we have seen though is across the breadth of our offer that's allowed us to trade at 1.3% like-for-like across the year.

The first half in particular was impacted by snow, we talked a little about that in May. We quantified the impact of that at about £12 million of sales although it did benefit from Easter. As we've gone into the second half we had the football and we had the sunny weather and you can see very clearly the impact of that. If you look at the split of our sales here and the strength of drink over food in the second half of the year.

Across the whole year in both those halves sales growth has absolutely been driven by spend per head and price over volume so it's consistent across the whole of the markets. And then lastly as I said earlier on we're encouraged by the first seven weeks of this year where we have built a little bit more momentum up 2.2%.

Cost headwinds remain a challenge for the whole of our sector. In FY18 we talked about a £60 million cost headwind and that's how it panned out. We managed to mitigate £28 million of that. Of course, wage rates, living wage and minimum wages are at the forefront of that both growing at over 4% a year. We've had transition increases on business rates, we had sugar tax, we had auto enrolment but we've managed to deal with those in the year gone past.

As I look forward to 2019 I think probably the outlook is marginally worse in terms of the headwind, not a lot probably £60 to £65 million headwind and the main forces in that will be energy prices which are going to be higher for us and food input costs. But a lot of uncertainty still in this area going forward, what we do know is those cost headwinds will remain and are unlikely to abate in the short-term.

A lot of moving parts in the P&L coming down to profits I've pulled those out in this slide here and I think you'll be familiar with most of them. We've got those inflationary cost headwinds of £60 million I talked about less our mitigation. Some like-for-like trading, the impact of our capital plans so that's investments we've made in the estate both those we made the previous year which are now annualising and those which we made in FY 2018 itself which are mildly diluting because we have pre-opening costs and closed periods associated with those.

And then we had the impact of some disposals we made the year before. So, in aggregate EBIT down £5 million, slightly lower at £303 million, as I say the first half was hit by £8m from the snow less the impact of Easter and in the second half we managed to drive some growth hence the stabilisation in the trajectory.

If I turn to the balance sheet clearly the largest asset by some way on our balance sheet is our property portfolio. We revalue this annually, 30% of the sites are visited each year as part year of that process; it's a very real process. And what I've done on this slide I've pulled together the movements for you, it can be a little bit difficult because some of those go to the P&L and some don't so this pulls it altogether.

So you can see we wrote down the value of our portfolio as a whole marginally over the year, we took a £15 impairment on asset values and that left about a £33 million write down on the valuation so very small in the context of the value of that asset, under 1% of the value of that asset and that really just reflects some of the performance we've had in the current year in our un-invested estates.

Building a balanced business is key to the three pillars of our strategy and what we're doing going forward. We spent £171 million on CAPEX in this year so that's pretty similar to what we spent the year before with some of the change in mix. We had an increase in maintenance CAPEX a lot of that was driven by our IT spend and that's backing the digital initiatives we're doing and you'll hear more from Phil on this later on.

From an operational perspective we invested in 239 sites so slightly fewer than the previous year. And also, the average spend per site was slightly lower which really just reflects that we've got a lower mix of conversions that require a lot of capital. I think next year if you're looking for guidance we'll probably see that drift up a little bit so that £171 million will approach £180 million; somewhere between £175m and £180m.

What is important though is that we continue to earn the returns that we require from that capital we spend and we're delighted with the improvement in the returns that we've had in the past year. Leasehold conversions and acquisitions have earned us 33% and freeholds have earned 21%. Where we spent money on remodels, so that's where we're refurbing a site but we're not fundamentally changing the offer or the brand, we're getting a 10% or more uplift in sales and EBITDA return of 27%.

So what the next slide does is it just tries to illustrate for you where we are on that journey with building a balanced estate. And as you can see we used to be on a 10-12 year remodel cycle we've brought that down to 6-7 years for a couple of years we've been running at that pace. And you can see here the impact of that on the estate so that centre bar is 2018 that's where we've got to.

What we're doing is just looking to reduce the average time since the last remodel across the whole of the estate and that gets us up to an equilibrium by around 2020. And then below that's a snapshot of where the estate is at the moment by year when the last remodel was done by site and as you can see there's a variety there and there's a tale there. Clearly the optimum remodel cycle for each brand will depend on what the band's proposition is but we still have a reasonable cohort of sites that are over ten years since they've received any investment that we need to get to grips with.

Those will overwhelmingly be wet-led pubs as opposed to the restaurant offers. Cash flow has been good on profitability we didn't benefit from disposals in this year so it's all pretty well operational cash less our fixed outgoings. And what you can see is we did pay down £60 million of net debt across the whole of the year and that's reduced our gearing further down to 4.0 times now at the end of the year.

Importantly, for when I talk about the dividend, we did not generate sufficient cash to fund all of our bond amortisation out of cash flow within the year so there's a £19 million increase in our use of short-term facilities or reduction of cash outside of that.

And that's really relevant to the dividend decision and as I said earlier we spent a lot of time on this 12 months ago so this should be very familiar to you. And we took you through how cash has moved around the group and how we allocate that capital. We also said at that time that we were concerned, healthily concerned, I think around the outlook for the sector and I would say subsequently a lot of those fears have become manifest in particularly the spate of CVAs you've seen through the casual dining group in the last year.

But what we've made clear is that in that difficult environment our priorities are to meet our fixed charges so that particularly will be our debt service obligations and will be the pension payments that we're committed to. After that we will maintain the condition and the competitiveness of our estate because that is the asset that the group trades with and we want to maintain a strong robust balance sheet.

To that end we don't believe that it would be responsible to pay out dividends if we're going to have to borrow on the short-term markets to do that and that's the criteria we laid out and that's why we will not be declaring a final dividend for this year.

What that does do is allow us to create value through deleveraging of the group particularly over time so this slide is a stylised version of the enterprise value of the group today on the left hand side with orange being equity, blue being debt and light blue being pension fund and we just roll that forward; if we follow our bond amortisation profile, keep up with our pension payments that's where we should be in ten years' time on an illustrative basis.

So, it shows how we grow the equity proportion of our enterprise value and if I just look at FY18 as I said before we paid down £60 million of debt, we've put just under @50 million into our pension fund so that alone is £110 million deleverage of the group even though we haven't paid a dividend.

So, I'll hand back to Phil but let me just remind you of those key messages, we're encouraged with the sales performance of the last year, we're encouraged about that continuing during the first seven weeks of this year so good start to the year. The conditions will remain tough in this sector but I think we're beginning to win in that market and we're looking to build further momentum for a whole range of initiatives that Phil's going to take you through now.

Phil Urban: Thank you Tim, good morning ladies and gentlemen. At our Interims I stood up and rather tongue in cheek talked about how the wrong type of snow had left us frustrated it had masked what we felt was real progress in our performance; instead of reporting flat profits our profits were still declining. Therefore I'm delighted to be able to stand up here today to tell you that actually despite Easter last year moving into the first half, despite the wrong type of sun (no-one wants to eat at Toby Carvery in 33c of heat); and the wrong type of World Cup we saw England enjoy a prolonged stay in Russia, despite those things we were able to report profit growth for the second half of the year, so more of that later.

I'd like to start by saying a little bit about the macro environment we find ourselves trading in. Clearly ongoing uncertainty about Brexit and the political instability that brings on is unhelpful. Our industry is already having to absorb unprecedented levels of cost increases which in many ways I guess are fast becoming precedented they seem to be there every year. We have an ongoing £60 to £65 million of costs to absorb on a like-for-like basis as Tim has outlined.

And that is before any costs that we choose to invest ourselves. The impact of things like living wage, business rates, utilities, cost of goods increases, sugar tax, the pension levy, the list goes on has been thrown at the sector at a time when the consumer is already under pressure. It's therefore no surprise to us that we are seeing these CVAs and closures. Something we predicted and it is something we expect to continue.

I think leasehold businesses where perhaps those cost increases have been exacerbated by increasing rent are the most exposed part of our sector. And often many of these businesses are dependent upon an anchor tenant in the leisure or retail space and of course there have been closures and CVAs in that market too so that's a difficult place to be and fortunately we're not that exposed to that.

The net effect of all of that is that the total number of licensed premises has fallen by 3.5% at June of this year across the whole of the UK. More people are eating out up 0.8% which means I think we're all ultimately social animals; frequency of a visit is down 6.2% which suggests to me people are cutting back. However, we can see that when people do come out they're willing to spend up on quality and indeed at our own average food spend or spend per head is up 5.9% and we know only about circa half of that is price.

Therefore, operators need to raise their game and anything mediocre won't cut it. This is a market share challenge in our view and M&B as big as we are we only account for 1.4% of total market supply by number of pubs and 3.8% in terms of value. So, there is a huge share for us to go at providing we get things right. And that brings me back to our trading update. I think the H2 results was an important milestone for us as a business as it proved to ourselves internally, let alone the outside world that we can stabilise this business.

Under the Ignite programme our first objective was to get this business back into sales growth and ahead of the market. And I think we feel we did this say over 18 months ago. You can see in this chart with the orange bars where we've traded ahead of the market. You can also clearly see the impact of the snow, the poor weather on the right hand side here and also the World Cup where other more sport-led businesses benefited at our expense.

Fortunately, once the World Cup had finished and people had been paid again our sales bounced back. The second objective therefore was to stabilise our profits and although FY18 finished £5 million down year-on-year, our H2 performance, and the acknowledgement that there were some exceptional events last year, gives me the confidence to say we're now hitting that aspiration.

Of course, we don't know what weather factors we have in the year ahead of us but we do feel that last year's weather coupled with the World Cup made FY18 a fairly unusual year. Our third objective therefore is to return this business to sustained profit growth which is no mean feat given the macro environment I described but that is exactly why we've embarked upon the Ignite 2 programme of work.

The approach we take recognises there's no silver bullet to turning a business like this around but instead it's the incremental gains made on numerous fronts that will ensure that you can actually overcome those cost headwinds. We remain focused on the three strategic priorities that we laid out two/three years ago now and they are as relevant today as they were when the journey started.

To remind you the first priority is about building a balanced business, moving towards the premium end of the sectors in which we trade, systematically raising the quality of amenity right across our portfolio and getting onto the six to seven year cycle of investment that we talked about and ensuring that each of our brand propositions remain fresh and grounded in deep customer insight.

Secondly, driving a commercial edge to the way we do business which is about putting the customer at the heart of what we do. It's about being really clear that each pound of sales converts to bottom line profit and in many ways Ignite 2 ensures that we can move at pace while we do this.

And finally driving an innovation agenda which is about making the technology in the business that we have work for us, making digital marketing an engine room for the business and being willing to trial new concepts and new product development.

Now as I described before, Ignite 2 is a huge programme of work, 43 different work streams, grouped under eight broad headings each led by an operations director and one of our functional experts. We've also set up a project office and we have a governance routine now that ensures we remain focused on extracting as much value as we can out of each one of those 43 work streams. Some of those work streams have already started to see some of their initiatives land in the business and value to start accruing, whereas others are far longer term and may well require net investment this year but will pay back from FY20 and beyond.

So, for example, during quarter four we trialled the removal of cash expenditure from our business finding cashless solutions for things like flowers, taxis and emergency food purchases. Now this immediately heightened visibility and control over areas of the business that perhaps we hadn't given much focus to but more importantly enabled us to use our scale buying power to get best price. With the success of that trial that has now gone live across the business from the start of this financial year and I would expect us to get some benefit from that process.

Similarly, the interrogative software that I spoke about at the Interims which allows us to analyse every single till transaction is now live in the business and enables our General Managers to spot unusual transactions and where unfortunately they have a dishonest member of staff on their team. And again, that's live in the business now.

During H2 of last year we also did a lot of work on our menus ensuring, for example, that we don't carry too many orphan products; those are products that only appear in one or two dishes and then due to pack size or shelf life lead to a high wastage so we tried to reduce those orphan products. And we've also done some work on revisiting our menu psychology making sure the menus are laid out in the optimum way.

All the learning from that work has been taken into account and the menu launches are happening as I speak so again we would expect to benefit this year from that work. Conversely the work on our stock system is an example of one of the bigger initiatives that's going to take longer to land and may well require costs upfront, but which when done should enable us to step change our stock control and drive efficiency.

This is a huge work stream where we're looking to introduce first remote counting then auto ordering and then followed by prep and par. Remote counting is all about speeding up the time it takes to do stock counts using barcoding and scanners instead of having to take manual stock count and automating the update of the stock result.

Auto ordering will create recommended orders for our General Managers and Kitchen Managers which they then only have to tweak which again speeds up and saves time for them. And then finally prep and par as I said before is a bit of software that cleverly tells our kitchen teams what product to prepare session by session again reducing wastage and also preventing product outages.

To get all of these things working seamlessly is requiring a huge amount of work by us but also with our suppliers and when it's ready to rollout will also require a huge amount of training. Ignite 2 plans down to this level of detail and whilst I don't expect much pay back from this in this financial year it's a key foundation for next year and beyond.

We also have a work stream looking at our whole approach to the digital revolution which is designed to enable M&B to be far more agile in its adoption of new technologies down the line. We are already seeing the benefit from a new CRM system which has step changed our ability to target our communication. And we've already improved the journey for customers wanting to book our restaurants through our website.

If their preferred restaurant is already booked up at the time they want to dine instead of the journey ending there they're now offered an alternative restaurant in that location that is able to accommodate them at their preferred time, a big move forward. However, it's the bigger piece of activity to open up our platform to third party technologies that will take some time to land but will lay an important foundation that the business will benefit from for many years to come.

Ignite 2 is a huge programme of work and I realise I'm asking a lot of my team to do this on top of day job but in a funny sort of way I feel it's energised the business and it's given people a vision and a purpose and if I'm perfectly honest I was somewhat relieved to see our engagement scores improve across every cohort of the business in the last six months.

And crucially our team turnover has improved for the role of General Manager, Assistant Manager and our Kitchen Managers. The industry is and always will be reliant on great people so those metrics are really important for our future success.

So, we feel we are building momentum, both in terms of driving our top line and in terms of driving efficiency. Now of course we've already covered a lot of ground over the last two years since Ignite was launched, we've taken Miller and Carter our premium steak brand from circa 30 sites to over 100. We've started to address the under-investment in other parts of our estate and I think the capital programme is increasingly becoming the engine room and driver of growth that it should be.

Our reputation.com call that allows our General Managers to manage all social media feedback through one portal is ingrained in the business and three years later we are light years ahead of where we were in terms of being able to be open to listening to our customers and what they're telling us.

We have had delivery up and running, with Deliveroo and Just Eat. We have sophisticated kitchen management and table management systems. Our online bookings are now seeing 130,000 bookings a week almost from a standing start in 2016 and still growing by 20% year-on-year. And we have our own award-winning digital learning platform which enables us to ensure that our 40,000 plus colleagues have the skills and knowledge necessary to serve our guests.

However, we don't intend to sit back and in many ways Ignite 2 is about pushing the boundaries. You will have read that we've entered into a joint venture with Ego restaurants which is a Mediterranean mid-market offer that already successfully operates in some ex-M&B managed sites. We see partnering in this was as just being another way of testing new R&D, taking learning from fresh thinking and of course sharing risk.

This year will see us open our first Miller and Carter in Germany, the ALEX team have embraced every element of the Miller and Carter brand and working with the UK team will open their first site in Frankfurt in the spring. Given the undoubted success of Miller and Carter here in the UK it seems logical to try it in a new market.

And we also continue with our innovation team in the background looking at developing our new concepts and new products that can be dripped into the mainstream business. The new year has started well with sales continuing ahead of the market with 2.2% like-for-like growth and we also have un-invested sales growth which proves it's not all coming from capital.

The current year capital programme is very much underway. We have over 60 schemes already completed and the Ignite 2 programme of work continues to motor on. Now as we always say the first few weeks of a new year pale into insignificance once Christmas is upon us and it will be the success or failure of the festive period that will dictate how strong our first quarter is.

Our total December and New Year bookings are comfortably ahead of last year but in truth it's becoming far easier for people to book so we're not getting complacent and as ever it will be the walk in business and the last minute business that will be key so our effort to keep driving books up until the festive period will not let up.

So overall I'm very pleased with the momentum we've built and we continue to build and with the activity that's underway in the business. We continue to trade ahead of the market average. Our H2 profit result gives us the confidence that this business has stabilised. However, the spectre of an uncertain Brexit and the political instability makes us still cautious about the short to medium-term future. It's a tough environment to trade in but we're convinced that the path we're on is the right one and that by de-gearing we are creating and can continue to create sustained shareholder value.