<u>Mitchells & Butlers 2013 Final Results Announcement</u>
<u>Tuesday 26 November 2013</u>

Q&A Session

<u>Question 1</u>

Richard Taylor, Barclays

Morning, Richard Taylor from Barclays, a couple of questions please. Net promoter scores up, staff churn down, like-for-likes flat. I appreciate there may be a lag here, but what do you think it is? And in a year's time with it still being flat, what will have gone wrong over this year?

And secondly, I appreciate the comments on Crown Carvery with the lower prices, but what work have you done to suggest that this still works as a carvery brand when you are giving customers best price on a non carvery product?

Alistair Darby, Chief Executive

Okay, let me deal with the second first because that is easy. What we are doing is, we are offering products alongside carvery like sausages, like fried fish, but the vegetable selection is the carvery vegetable selection. So effectively you go up to the carvery deck, you can take a piece of fried fish and then you serve yourself to vegetables. So the complexity that we are introducing to the offer is very low, all we have done is put in fryers. And you are effectively using the same vegetable choice as you were before. The other thing though we have been able to do and this is important in this market, is we have been able to introduce chips because formerly potatoes were mash or roast and you can probably appreciate in this market, chips are important. So that is quite a big guest appeal feature. And the other thing we are trying to do is make sure we can develop and offer food on the deck that we can cook off not only in fryers, but also in existing carvery kit. It is important to remember that the kind of kit that we use to cook roast is also multi-use so you can use it to cook other food as well, chicken for example. So we are pretty content that by just putting in a bit of kit into Crown, that we haven't kind of overstretched the offer.

The biggest issue in Crown has been, when you put fryers in, you have to, it is a bit boring this, but you have to put in extraction hoods or extend extraction hoods and that is probably what has delayed us in getting that done. So I don't think we should worry about that at all, I think we are in a good place on that. And of course as you get, remember we have lost about 20% of our volume in Crown, so as you start to build that back in, you get the efficiencies that flow from that. So we are pretty confident that this is going to work.

As far as like-for-like momentum. I think the honest answer Richard is we would expect to make progress this year. We are very convinced that the priorities we have got and what we are working on is going to flow through. If that doesn't work, then we are going to have to have a pretty long, hard look at ourselves. But it is quite hard to think that by having better people, delighting guests, that that isn't going to have an impact on sales. And an impact of sales in a positive way, because that really is the key for us, is that we are just really, really keen to make sure that we have got the right amount of promotional activity in our business, but not an excessive amount of promotional activity. Because once you have given away your margin position, it is very difficult to get it back and we are very keen to protect that by improving sales through long-term important things. So we are pretty confident it is going to come through. We think we are doing the right things and we just have to be diligent and plug away at it.

Question 2

Victoria Grier, JP Morgan

Victoria Grier from JP Morgan. First on the new site openings please. Could you give us perhaps a bit more of a feel about pipeline, numbers of sites you are looking at and considering at the moment?

And then also for the new openings, what do you see as the right level of EBITDA return? Is it the 17% blended that you have got already?

Tim Jones, Finance Director

In terms of number of sites, we have got about 40 we are looking at at the moment. They are not all for this calendar year though, some of those will be FY15 and some even FY16 openings. To give you a sense, that is ten more than we would have had, if you had asked me that question 12 months ago. So we are basing our acceleration in the new site openings on the fact that we have a richer and larger hopper of sites we are looking at at the moment.

In terms of returns, I think we need to increase returns from where we are. I think from a freehold perspective, we are currently at 13, I think we would like that to be 14, maybe even touching 15. And leasehold we are currently at 18 and we would like that to be, sort of, well over 20%. So we would like that to be you know 20 to even 25% going forward.

Question 3

Jamie Rollo, Morgan Stanley

Thanks, Jamie Rollo from Morgan Stanley. I think on the last call you talked about 1 ½ to 2% like-for-like guidance for the year. Can you still commit to that for the rest of the year?

And I have some questions on costs. Do you see any upward cost on wages, given you want a happy labour force and clearly employment levels are quite high in the UK?

And then, also, on pre-opening costs. Will the ramp up in openings be material to the bottom line this year in terms of those additional opening costs? Thanks.

Tim Jones, Finance Director

Okay, so the costs, opening costs. Like-for-likes, 1 ½ to 2% as you said, that is what we are working to for this year and that reflects what Alistair said, that we believe we will start to get some of the benefit of what we are doing. I think a lot of that will be volume driven rather than price, but that is what we expect for this year.

In terms of our cost base, staff costs in particularly that you mention, we are most sensitive to the minimum wage so that is £6.19 to £6.31, so that is about a 2% increase. And that is really the best proxy to use for our overall wage bill. Because, whilst that impacts those directly on minimum wage, we need to keep a hierarchy above it. So the whole cohort tends to move similar to that. And I don't think you will see us outstripping that in what we are giving across the labour force. We are looking to achieve engagement through other means.

And in terms of pre-opening costs, that was your other question. Part of the margin enrichment this year is because we have slowed, so we have had less of a drag from pre-opening costs. As we accelerate we will have that drag. It is obviously only temporary and it only reflects the acceleration between one year and another. Once you plateau out, it disappears. But yes there will be a drag for, I expect, FY14 and FY15, against the percentage margin based on an increasing level of pre-opening costs. It could be a couple of million - delta between the year.

<u>Question 4</u>

Geof Collyer, Deutsche Bank

Geof Collyer from Deutsche. Three quick questions. Can you split out the impact of the stronger wet sales in the summer in terms of the 50 basis point in margin?

Secondly, given the step up in capex towards the upper end of the £50-80 million level, is that going to restrict where you could possibly re-instigate the dividend when that position comes about, given there is quite a big increase in cash outflow?

And then thirdly, on the pension front, you talked about adding the £240 odd million into the balance sheet, we are still talking though about the potential £600 million funding gap discussion that is ongoing with the Trustees aren't we? Thanks.

Tim Jones, Finance Director

Yeah, in terms of margin Geof, 'not really' is the answer. Gross margins between food and drink, drink is slightly richer as you will know, so one can see that. Most of the benefit comes through labour and the fact that it is less costly to serve drink than it is to food. So it does help our margin, but it is not a calculation that we have done I have to say to go through and work out what the second half drink sales did to that. I wouldn't expect it to be substantial within the movement.

In terms of dividend, for me, the dividend is a consequence of the cashflow, not an input into the cashflow. So we have our pension commitment, I will talk about that as you asked. And we need to determine what is the right pace of expansion for the Group, both in terms of maintenance capital, if we are investing in tills and what have you, and also in terms of new sites. And that will be determined by what is in the market, what we can execute and which brands we have got ready to expand. And if we can do that, we will earn the highest return. The dividend decision is then - when are we generating enough cash post all of these calls to be able to fund a dividend? So it comes last if you like, and at that stage - we review it regularly as I am sure you would expect us to - at that stage we will declare a dividend when we are clear that we can fund it with in-year cash flow.

In terms of the pension: yes, a lot of people have used the sensitivities we disclosed to come up with that 600 number you talk about so you know I am familiar with that. And nothing will change the valuation date which is 31 March and nothing will change where gilt rates and financial conditions were at that date. Obviously, gilts have come back a little bit since then. We hope, you know, to be able to reflect some of that, but there is no automatic mechanism to do that. It just gives us, if you like, a slightly more benign environment that we are conducting the negotiations in, than if the deficit was getting bigger while we were talking about it. So those negotiations continue in that same vein.

<u>Question 5</u>

Tim Barrett, Nomura

Tim Barrett from Nomura. Just going back to volumes, you have obviously put through the changes in Crown post year-end. So for the year as a whole, were value brands still down double-digits in volume terms? And conversely were there brands in good growth?

And just a small question on asset values. Can you say how many pubs roughly are above the £3 ½ million cap outside London and is that having any material impact on the estate? Thank you.

Alistair Darby, Chief Executive

I think the encouraging thing for us is that we saw a slackening of the volume decline in value brands in the second half. So we had a better second half than we had a first half which was encouraging. Still in decline, but nothing like the rate we were in the first half. And we would be hopeful of that trajectory, with everything we are doing, will continue upwards this year. It would be fair to say that clearly, and we have been very candid about this, the volume trajectory in those value brands has been much weaker than in our brands for example, Harvester or Toby or inner London brands. And we want to redress that balance in this year.

I don't know the answer to the number of pubs…

Tim Jones, Finance Director

About 30% of the pubs are over £3 ½ million valuation. Much lower outside of London. I would guess maybe 10%.

<u>Question 6</u>

Jeffrey Harwood, Oriel

Jeffrey Harwood from Oriel, I have got two questions. First of all on the EPOS system, where do you see the easy wins coming there?

And secondly on the cash balances outside of the securitisation of £260 million, that is clearly an opportunity there. I know it has not been a priority in the past, but do you see that changing any time soon, please?

Alistair Darby, Chief Executive

I think to answer the question about EPOS easy wins, I think the most straight answer I can give to that would be speed of service. It is speed of service and time. There are two things that the new system does, one it means we can transact business much quicker, either at table or at bar in any number of ways. Also, it means that when it comes to starting up the system at the beginning of the day and closing down the system at the end of the day, the whole thing just runs infinitely faster. So, historically it would be pretty normal for a manager to have to take an hour in the morning to warm up the valves and get the system going, and probably another hour to close it down at the end of day. Opening and closing now is instantaneous. So the effect of putting those new systems in is freeing up management time. And that is really important, because it frees up management time that can be spent developing people and the guest offer. And so those will be the most immediate effects. But that is not all, there are some deeper, longer term effects, not least of which I think, how we use the wealth of data we have got about customers to interact on a much more personalised basis as people visit our outlets. And that can be very exciting. But that is further down the track.

In terms of cash balances, I think it is fair to say that we would like to use cash balances to create greater value for our shareholders. We will consider all opportunities that are available. You know part of that, clearly, is having a bigger expansion pipeline and if there are opportunities that are worth looking at in the market we will do so. So we were pleased to acquire the four Convivial pubs. If there are those kind of opportunities around then we will take a serious look at them. And if we can see them creating value for our shareholders over and above the value that cash is presently creating, then that is something we will do. Because that would be a very sensible use of the money.

Question 7
Lena Thakkar, HSBC
Lena Thakkar from HSBC. Two questions if I may. Alistair you talked about the Heartland estate and obviously how volumes have been falling there. I just wonder if you have, sort of, taken a step back with that part of the estate and looked at whether it does actually sort of decent enough returns to stay within the Group or whether it might be worth looking at alternative options?

And then secondly just on scores on the doors, and apologies if I missed this, but did you talk about where you are at the moment versus your targets and your peers? Thanks.

Alistair Darby, Chief Executive
Okay, let's deal with scores on the doors first. I think if I am correct, there is only one restaurant business in the UK that across its estate achieves clean 5's in every single outlet and that is TGI Fridays, who have 60 restaurants in the UK. So well done to them, but that is obviously only 60. So they stand a better chance than 1,600. We are in a position at the moment where the vast, vast majority of our estate is 4 or 5 rated. There are a few laggards that are 3's and we need to get them up. The challenge now is for us to move the cohort of pubs that are on 4's into 5's. I mean our ultimate ambition would be, and this would be pretty unbelievable if we could do it, would be to get 1,600 pubs at 5. We are not there yet, we have made a lot of progress, but that would be a very significant step forward. But we are pleased with the progress we have made this year.

As far as the Heartland estate goes, I think what I would say is that, the honest answer to your question first of all is that Heartland estate has been reviewed and the consequence of that was the sale of 333 pubs to Stonegate. The Heartland estate that was left behind was left behind for jolly good reason, and that is a very well established, strong, freehold estate with some exceptional prime sites in communities. The issue of course in this market is that, as we said before, the 2 to 3 lowest income deciles in the UK that are big users of those pubs have suffered disproportionately in this period of austerity. And so at this moment in time that market has been very difficult. Do we think that market will recover? Yes we do in the fullness of time. And we think it will be absolutely the wrong thing to do to consider getting rid of such high quality freehold sites at this point of the cycle, or any point of the cycle because we think it is going to come back. I think the key for us is that we have got to get the value messages stronger, recognise that cash is tight for those consumers. That will improve our competitive position and then we have the option as and when things pick up which I am sure it will do, we will still own these pubs and we can drive them further forward. So I think that is the right and proper thing to do.

And you know the truth is, it is not that we have even considered selling that Heartland estate, so we haven't considered it. But even if you did, you would then get to a point - well, every estate has a tail and as I often remind people, our tail - or what is perceived as our tail - is probably the upper quartile or at least second quartile of other people's estates. Don't forget, we have, average estates, £23,000 and although Wetherspoons and Restaurant Group are higher than us, they have weaker margins, and a number of our competitors are probably £3,000 to £4,000 a week lower than us. So you have just got to put what is perceived to be our tail, which we don't see it that way, in the context of other people's estates. And that is the way we think about it, this is too good an estate of pubs to be selling into the market.