Mitchells & Butlers Plc – Full Year Results 2022 7 December 2022

Phil

Good morning, ladies and gentlemen. Following COVID-19 and of course all the associated lockdowns, the continuing fallout from the war in Ukraine has certainly made the macro landscape challenging, to say the least, but despite that we're actually quite pleased with the progress that the business has made, and had it not been for the eye-watering increases in utility costs last year we would have all but recovered to pre-COVID levels of profit last year despite the Omicron variant which wiped out the most crucial festive season, despite the other exceptionally high cost increases, despite the delivery issues and despite the well-reported people issues that we had to contend with. We've also started the year, as you will have seen, very strongly with 6.5% like-for-like sales growth over the first 10 weeks, which is incidentally 9.2% up against 2019, so they are the reasons why we're very pleased with the progress the business is making.

We're trading ahead of the market again consistently and we have a solid capital programme already up and running and in place, which is methodically raising the quality of our amenity, and Ignite, our transformation programme, is once again up and running and generating sustained improvements to the way we do business on numerous fronts. So, despite the macro environment we believe we're absolutely on the right path.

This morning Tim is going to begin by taking you through the financial results and then I will return to bring you up to speed with how the business developed through the course of last year and to demonstrate to you why we're feeling so positive about the months ahead which we believe will put us in a very strong position once the macro headwinds start to subside. I'll then move on to the priorities we have for the business and our programme of work for this year which we believe will take the business even further forwards. Let me start by handing over to Tim.

Tim

Good morning. As Phil says, I'm going to take you through the financial performance of the group, we'll talk a little bit about the recovery in sales and what we're running at at the moment, some thoughts on cost challenges which I think are front of mind, where we think that's going, and then I'll return to profitability and the cash generation of the group.

Let me start with the income statement for last year. We made a profit of £240 million, clearly the prior year was decimated with lockdowns and restrictions but that £240 million represents a really encouraging and strong bounce back of profitability, and as Phil said, ex utilities that's very close to the levels that we were pre-pandemic, so very encouraging across the whole of the year. As always, that recovery is built on sales growth since we first opened about 18 months ago, you can see that clearly on this slide. Now, the rate of VAT obviously changed so it's probably better to focus on the line rather than the bars, that strips out the impact of the change in VAT, but what you can see is a really robust growth in sales over the whole of that period and really encouraging to see the consistency of that, and where it has come off track like Omicron there's a very defined reason for that.

That's continued at the end of the financial year into this year, the first 10 weeks, as Phil said, we're now up at a slightly higher rate of 9.2% against FY19, so it's also a really good start to the current financial year.

In terms of the general themes of what's driving those sales, a few movements, a bit of volatility. Initially our sales were driven largely by food, latterly drink has started to be stronger for us. Initially suburban and rural areas were very much stronger, latterly we're starting to see footfall return to city centres, that's beginning to catch up, and initially sales were very much driven by spend per head, premiumisation and price whereas again latterly we're starting to see volumes come back. So, whilst we're still some way below our FY19 volumes, year-on-year now in the first 10 weeks of this year we're ahead of volumes a year ago. So, really good sales performance last year, really great start to this year. I have to say, we're mindful of the potential impact of the cost-of-living crisis of course on guests going forward, we don't know what that will hold, but it's fair to say that it's not substantially evident as a risk in terms of what's coming through our tills at the moment.

I think what we know is the future's going to be dynamic and the future's going to be uncertain, so it's probably worth re-emphasising the wide breadth of brands and offers that M&B does have, whether it's a food occasion or a drink occasion, whether it's premium or value, and whether the location is rural, suburban or city centre, we've got a presence in most parts of the market, and that excellent coverage I believe should give us a measure of resilience as we go forward in a market and a sector that is going to continue to be fast-moving, fluid and volatile.

If I just look at the moving parts of the P&L last year, we continued to invest in our estate, that's very important to us. We've not managed to execute as large a capital plan last year as we'd like, that's entirely due to logistical supply chain reasons and frustrations getting planning consent, but it was very important to us to maintain investment in our estate. What dominates this picture of course is cost inflation; this is across three years, remember, from 2019 to 2022, but a £70 million increase in energy, so nearly doubling in our energy bill, and an overall cost headwind of £218m, so that represents a very stiff challenge for us, and I'll talk a little bit about what we think the future holds.

We had a bit of government support, just over £50m, almost all of that is the reduced level of VAT, and then we've got what we've managed to achieve and that is, I have to say, despite the impact of Omicron which cost us the lion's share of last year's festive season, we've still managed to generate efficiencies, drive sales improvements and premiumisation and price as well to arrive at £240m for the year. The costs and what costs hold for us are very much front of mind and I think a key focus.

If we look forward to the rest of the current year, and I have to stress really that we're giving you our best view here, it feels somewhat brave at times and it's difficult to predict with any certainty, but this is just our best view of what we're heading into. We think across a 1.8bn cost base for M&B we suspect our headwind of costs will be about 10% to 12%, so call it 10% on a base case scenario, maybe 12% on a downside scenario. Energy is a big part of that, we're going to benefit from the energy cap in our first half, whether that gets extended or not we'll find out in a few weeks' time, but we'll at least have it for the first half. We've got 45% of our energy bought forward for this year but despite the cap and despite that we still expect a small increase in our energy bill for the whole of this year. Labour's a big cost for us, always has been, it's probably the most stable and predictable actually though as we look forward to the next year. We know that living wage is going to go up by 9.7% to £10.42 an hour, that'll be 1st April, so that will only impact the second half of our year. Longer term I see no reason why these levels of inflation are going to continue and why it shouldn't revert to what we've always talked about as our historic cost headwind norm of £65m, just over 3%,

and indeed in the next year or two I would hope we get some form of energy deflation, if we come down from the very high levels we're at at the moment, and we might even be below that trend for a year.

In the light of that cost challenge, I think it's really encouraging to see our cash performance, so we've generated positive cash in the year, we've reduced our debt further by just over £70m, so we're now under £1.2bn debt excluding IFRS 16 liabilities, that's £350m lower or 20% lower than we were going into COVID, so our balance sheet absolutely does continue to strengthen and we'll look to drive down that level of debt further.

We've revalued our property portfolio, as we do at least every year, resulting in a small downward movement but we still have net assets across the group of over £2bln representing about £3.60 a share, so a strong underpinning of the value of the group.

Before I hand over to Phil I would like to say a few words about pensions which after many, many years of paying £50m into deficit recovery we're now starting to believe that we're beginning to see the light at the end of the tunnel on this. Our most recent triannual was at March of this year, we're very close to signing that, so we have a degree of confidence in the outcome although it's not completed, and we expect to see a significant improvement in the funding position. Our main scheme that constitutes about 80% of our liabilities, we've been putting £40m a year into that scheme, we're contracted to do that until September next year, so another 10 months. We're well on track for that to be the end of the contributions, and indeed once we've signed this triannual, we'll look to start to divert those contributions into a blocked escrow account rather than into the scheme themselves.

The executive scheme, which is the other 20% of our liabilities, as you'll know we achieved a buy-in a year ago, so that scheme is substantially de-risked, there are very limited future funding requirements. We've already been putting our contributions into a blocked escrow account, and we would hope perhaps one day we could even recover some of those contributions at some stage.

So, overall, I think a really positive movement in terms of our pensions position and we're tantalising close now as a group, I think, not to have this £50m a year cash outflow that we've had to carry as a constraint.

So, that really is it. Pulling it all together, I think really encouraged with how sales recovered last year and how we've started this year ahead of what were our initial plans. The costs are going to remain a challenge and that outlook is uncertain but there are a number of plans to try and deal with that and Phil will take you through those in some more depth. I think we benefit from the fact that we have a great diversified portfolio of strong brands in good locations which leaves us really as well placed as anyone to face the challenge that we have coming for us in the future. Thank you.

Phil

Thanks Tim. As I said in the introduction, we're pleased with the progress the business is making and once the macro headwinds subside, we think we'll be in a very strong position. To explain that I'd like to begin by giving you the reasons why we are feeling so confident about the months ahead.

As Tim said, we finished the year with like-for-like sales growth of 1.1% versus FY19 which when the VAT is stripped out demonstrated a gradual build through all four quarters. As you know, initially the

food-led businesses in our suburban locations fared better than wet-led and city centre businesses did, but as the year progressed and as society learned to live with COVID that gradually changed. Towards the end of the year our wet-led businesses started to fare better. For example, Nicholsons, a brand I'm sure you all know well, was really struggling a year ago when the city centres were relatively empty, the work-from-home mantra was being peddled in the media and there was almost a total absence of foreign tourists. A year on and Nicholsons finished the year very strongly beating all of our expectations and it's now in solid growth and arguably it's probably leading the way for us. We're seeing our premium food-led businesses with a flatter performance at the moment as they compare to last year when they shot out of the blocks when our customers were making up for lost time. Of course, if we normalise for the 12.5% VAT they were enjoying at the time then they too would be in solid growth right now. This illustrates, I think, a shifting picture that has been going across the sector with more people returning to offices, city centres becoming stronger and older guests becoming more confident to venture back out and go back to their locals. This is the first reason why we are optimistic about the future as we see a strengthening demand as society learns to live with COVID.

Last year was also challenging on a number of fronts, notable amongst these was the people issues, the well-reported staffing issues that the sector was facing driven by losing people during furlough to other sectors and by the absence of the EU talent pool post-Brexit. This put a lot of pressure on our recruitment, particularly for back-of-house roles. As the year progressed those recruitment challenges improved, apart from certain hotspots around the country where we had to beef up our recruitment campaigns. However, as recruitment started to ease, so retention became a bigger issue than it had been historically. We put this down to people just struggling to get back into work life again after periods of lockdown, and that is and will continue to settle down. This is the second reason why we're confident about the year ahead because we achieved last year's results despite huge people issues. Today, while there are still some issues, they are far less impactful than they were last year.

Success in hospitality is inextricably linked to customer satisfaction with the correlation between superior guest scores and strong like-for-like sales being irrefutable. When we reopened our doors after COVID we were delighted to see our guest review scores strengthen from an average of 4 out of 5 pre-COVID to 4.3 post-COVID. Initially we put this down to us enjoying a bit of a honeymoon period where people were just pleased to be out again, and to the pared back menus we were operating that allowed us to get the food out quicker. However, as the year progressed, we were delighted to see those guest scores maintained with critically every single brand being over 4 with scores ranging from 4.1 to 4.6 out of 5. This is a great foundation to build upon and all brands are now focused on strengthening this even further. So, the trust in and love for our brands is the third reason why we're very confident about the months ahead.

Clearly, as COVID19 refuses to disappear entirely we are keeping fingers crossed that there is no repeat of last year's 'stay away from Christmas parties' soundbite which destroyed the last festive season, I think we're getting close now, hopefully that's not going to happen. Sir Chris Whitty's ill-timed comments last year, you may remember, resulted in immediate cancellation of Christmas bookings, and so last year's result was achieved despite the loss of the most crucial festive season. As long as there's no repeat we expect a very good December, and so far so good, Christmas bookings are looking solid as people are looking to make up for their lost Christmases over the last couple of years. This is the fourth reason why we're optimistic about the current year.

To re-cap, the strengthening propensity for our guests to come out as they've learnt to live with COVID, the gradual improvement in the recruitment market, the improving guest satisfaction scores, and a good Christmas season ahead of us are all reasons to feel confident that we can continue to build over the coming months.

However, there are some macro challenges to overcome, not least the unprecedented cost headwinds the biggest of which are undoubtedly utility costs and food costs. Utility costs for us moved from £80m to £150m post, which as I said earlier makes up almost the entire shortfall to FY19 profits. As you would expect, we have a number of Ignite initiatives underway to try and reduce consumption, without detracting from the guest experience of course. Voltage optimisers and endotherm which makes water boilers more efficient are examples of capital-driven initiatives that we have in place to drive down usage, with voltage optimisers alone projecting an 8% electricity consumption reduction. On top of that we have a network of energy ambassadors across the country who work with each site to audit the energy efficiency of each business and to produce an energy action plan specific to that business; these plans will include everything from when to turn the ovens on in the morning to how to reduce draughts and improve insulation. As a result, there is a programme of work underway to improve that insulation, to replace thermostats and to give each business a chance to optimise its energy consumption.

With food costs we're currently still faced with high commodity costs across all lines, however we are flexible in the way we procure and we're constantly looking for ways to limit exposure to those lines that have the highest inflation at any one time. This may mean we have a higher level of product substitution than we would normally have, or we might reduce some items entirely, so for example lamb was taken off the carving deck in Toby Carveries for a period of time, I'm pleased to say it's back on now, but that's the sort of thing we can do to try and limit exposure to particular costs. We also look to use our scale purchasing power where we can, and we look to procure across all brands that gives us some scale advantage. Food costs I'm sure will remain inflated while the war in Ukraine continues, but we believe we will see some easing this year as the COVID and Brexit driven side of that cost equation starts to subside.

The next major concern or macro concern is what impact the current cost of living crisis will have on consumer spending, as Tim alluded to. There's no denying that our guests will be feeling the impact of rising energy costs, rising food bills and now rising re-mortgage payments too, however it's also fair to say that we are yet to see any impact on our trade, but we accept that it's likely to be January when the festive season needs to be paid for and energy bills will be at their highest that any impact may be felt. However, our sector has always proven to be resilient in previous recessions as people tend to cut back on other luxuries before compromising on day-to-day activities. There is also the fact there is still a gradual return to our sector post-COVID for some of our guests and we think this will partially offset any drop in frequency. Finally, the high utility and food costs will accelerate supply coming out of the market which undoubtedly benefits those that remain, so we remain cautiously optimistic in our ability to withstand any consumer spending issue.

We continue to work on our three key strategic priorities that we believe will ensure we can deliver on our aims. Firstly, maintaining a balanced portfolio so that we're not over-exposed to any one market segment and that our brands are kept relevant and grounded in deep customer insight. We aim to invest in each business on a circa 7-year cycle, and then when we do invest, that we invest fully, looking at the externals, the toilets and where possible bringing unused parts of the business back up to scratch.

The second priority is about driving a commercial edge to the way we do business, and this for us is about ensuring that the guest is at the heart of all our decision-making and that we're constantly listening to their feedback. It's also about being clear on how each pound of sales is converted into bottom line profit, so for example when the business opened post-COVID it allowed us to be forensic about analysing how each promotion we ran was really working in the business.

The final priority is about driving an innovation agenda cross the business, firstly sweating all the technology that we already have deployed, secondly ensuring that digital marketing is an engine room for the business and that we stay ahead of the competitors in this space, and finally ensuring that we invest in new product and new concept development and be willing to take the learnings back into our core business.

To achieve our priorities we have three levers that we pull each year, namely the strategic decisions we take around pricing, menu content and offer development, secondly the capital programme where we decide how much capital to invest and where to deploy it, and finally Ignite, our change programme, which seeks to ensure that we have multiple initiatives underway at any one time that together in aggregate added up to a big number. So, how are we doing?

Let's start with menu development. We've been really cognisant of the current high food cost inflation, and we also try to reflect the need to reduce menu complexity so we can keep up our speed of service. Most brands have a menu change in the autumn and again in the spring while some simply run on an annual cycle supplemented by seasonal specials. We have taken more price than we traditionally do during this latest cycle, moving price on food and drink by circa 5% although we've worked hard to protect entry level items where we can. We've not just bluntly moved price; we've sought to introduce more premium items at the same time and hence maintain value for money. Whilst well below headline inflation numbers this is still a large increase by our standards, and we've worked hard to ensure that there is still something for each of our guests. So far, the guest reaction has been very good, and we can't see any deterioration in frequency, but we are remaining very focused on guest sentiment and trying to ensure that service levels and the amenity makes the overall experience positive. Current volumes are very strong versus last year and sales after 10 weeks are tracking 6.5% of like-for-like sales growth, as I said earlier, 11.1% if you normalise for VAT, and also up against 2019 at 9.2%.

Pleasingly, we're also tracking ahead of the market on the Peach Tracker again, which is the data pool that maps circa 50 of our competitors on a weekly basis where we share our sales confidentially. COVID distorted the ability of the tracker to have clean comparative data and so used FY19 as its base year which gave an advantage to all the brands that had grown their delivery business since that time. Despite that, you can now see that the gap to the market that we had pre-COVID has emerged again, and we would expect this to strengthen further when Peach starts to use 2022 data in January of next year.

Our capital programme is also well underway. As previously reported, the construction sector was also massively impacted by COVID and now by the war, so cost and availability of labour and materials has been an issue. The planning authorities are also struggling with a huge backlog of applications which is slowing development down, however we still aspire to have a full programme this year which will enable us to get refurbishment back underway in each of our brands. As predicted at the interims, we opened our first Browns restaurant in a suburban location converting a vintage inn in Beaconsfield, the site has been open for circa 12 weeks and we're delighted by the sales uplift we're seeing and the customer comments we've had. With Christmas around the corner,

which Browns is ideally suited to, we have very high hopes, and the second suburban Browns opened in Ruislip last Thursday and is already booked out for Christmas Day.

The return on investment from last year's overall programme is difficult to calculate given the disrupted base years, but the sales and uplift have been very strong suggesting returns have strengthened. This year we also intend to invest in solar panels for some of our sites and so final capital allocation is still being determined.

Moving on to Ignite, Ignite has served us very well since its inception in 2016 and we currently have between 45 and 50 separate initiatives live in the business or in train within the business, from enhancing order at table capability and optimising Christmas trading between Christmas and New Year, to focusing more forensically on our top 300 businesses and looking at food and drink surpluses in a different way. As mentioned before, we have auto labour rostering being rolled out later this year which potentially drives a big efficiency gain but also ensures that our teams are optimally deployed to reflect the patterns of trade. We're pushing on with our delivery and click-and-collect plans which together drove over £45m of sales last year, and we've opened a trial of our first Toby Carvery dark kitchen out of O'Neill's in Clapham and we've also opened our first competitive socialising darts concept called Arrowsmiths out of another O'Neill's in Solihull that has got off to a very impressive start. Ignite remains the umbrella term for a high energy programme of very varied initiatives that together in aggregate will drive a meaningful incremental profit. The point to remember is that these gains are sustained and so Ignite is also a programme that systematically raises the bar in terms of the quality in the way that M&B does business.

Meanwhile, despite the challenging macro environment we remain committed to our ambition to enhance the sustainability of our operations and to reduce our environmental impact. We've made good progress during the year with our greenhouse gas footprint including scope 1 and 2 and crucially 3 emissions now sitting at 36% below our FY19 baseline. We're on track to achieve our target of zero operational waste to landfill by 2030 with 96% diversion in the year just gone, and we've reduced our food waste in our supply chain and our sites combined by 29% against FY19, putting us on track to deliver our target of halving food waste by 2030. We have a number of initiatives live in the business including reduction of food emissions, trialling all-electric kitchens and trials of onsite renewable energy generation to ensure that we continue to push on in this area and ultimately make sustainable operation just part of doing business for the future.

That is the backdrop for the year ahead with a lot of activity already underway. Whilst we feel confident in where we are and what we plan to do, we are acutely aware that market sentiment for our sector is very poor at the moment, presumably for the macro reasons stated earlier, however it's worth reminding you that we are still a business backed by 83% freehold or effective freehold estate with strong brands valued at between £4 and £4.5bn with £1.2bn of debt and with a pension deficit that should disappear by the end of this financial year and which will no longer require any contributions. We've got off to a good start this year running at 6.5% like-for-like sales growth, and we believe the underlying health of the business is very good in terms of trading and that that the macro headwinds which we can do little about are and will be temporary. Whilst short term profit has been negatively impacted the potential for a quick and full recovery once the macro issues abate is very strong, and that is why we're continuing on the same strategic path that we were on pre-COVID as it's as valid now as it was then.

As I said in the introduction, and to remind you, we are trading ahead of the market consistently again, we have a solid capital investment programme and track record, methodically raising the

quality of the amenity across the portfolio, and Ignite, our transformation programme, is once again in full flow driving improvements that will be sustained to the way we do business on numerous fronts. So, despite the macro environment we remain confident that the business is on the right path and will now be happy to take your questions. Thank you.