Mitchells & Butlers plc

Half Year Results

Wednesday, 16th May 2018

Tim Jones, Chief Financial Officer

Good morning. My name’s Tim Jones, CFO of Mitchells & Butlers. I'm going to take you through the finance section by results. I'm then going to hand over to Phil.

Let me start with a summary if you like though, we’re really encouraged by the last half year’s trading. On the sales front we continued to improve and most importantly stay ahead of the market. The market conditions themselves are tough but they remain tough and they’re no tougher than we’ve been talking to you about for two years now. So that challenge is well-defined for us. And in the light of that we believe we’re beginning to get cut through for a lot of our initiatives that you'll hear more about today to the extent that we’re able to stabilise profits. And perhaps most importantly we have a new wave of initiatives and profit drivers which Phil’s going to take you through in the second half of this presentation.

But let me start with trading. Our sales increased by 0.6% despite the fact that as you'll know we sold nearly 80 pubs early in the second half last year.

Operating profit after a number of our cost headwinds was down 5% to £141m and this flowed through to PBT and to EPS. Now there's a number of drivers behind this performance and what I’d like to do is quite carefully take you through each of those.

But perhaps the most stark of those was snow in this period. Clearly as a business we control our own destiny, we control our own performance but in the very short term, as you'll all be aware in this sector, we can be dramatically buffeted around by extremes of weather in either direction. And these six months were no exception to that in that we had four bouts of snow and we reckon that had an estimated sales impact of about £12m adverse to us. And you can see here on the chart which just shows you since the beginning of the calendar year quite how abruptly sales can fall off when we do get heavy bouts of snow.

That impact for us was particularly more acute here because most of those snowfalls came on a Sunday which is one of our key trading days, so that has a disproportionately negative effect on our food-led brands rather than wet-led. Indeed some little pockets of our estate, suburban wet-led pubs did quite well but in aggregate it was clearly negative to us.

And the impact on profit is further exacerbated by the consequent repair spend and a little bit of food wastage as well. We’d estimate that it probably cost us about £8m of operating profit across the various bouts of snow.

Just as a post note if we were to adjust our like-for-likes in the first half to add back that £12m they would have been 2.5% up.

So coming on to sales, I've mentioned snow, going the other way we did benefit from Easter in the first half of this year which we didn't have last year, so that partly offsets the impact of the snow. Easter clearly reverses out if you look at the week 1 – 32 number, so that takes you right the way up to last Saturday and as you can see that stayed pretty flat on where we were at the end of 28 weeks at 1.4% which demonstrates how well we've traded conversely in the last four weeks where we've had really, really good sunny weather, the flipside of the cold weather we'd had previously.

I have spoken at these presentations earlier on this year a lot about calendar like-for-likes and reported like-for-likes and we get shifted a little bit out of line by the 53 weeks accounting year last year. Those were very, very similar at the end of the six months so I'm not going to labour on that any more but 1.3% plays 1.4%.

And then lastly our sales growth continues to largely come from spend per head in particular driven by premiumisation of the estate and you'll hear some more about that with volumes continuing to be slightly negative both for our business and for the market as a whole.

Cost headwinds and inflationary cost headwinds remain a challenge for us and for our sector. Minimum wage and living wage still increasing by a little bit more than 4% a year. We're getting still transitionary increases in business rates that are coming through and clearly we're picking up sugar tax from April as well.

I think what is important though is the outlook and the cost outlook is no worse now than we've been talking to you about for 18 months and two years. So we understand the challenge and we're expecting to start making progress against that and you'll hear a little bit more about how we're going to do that.

So if I pull a lot of that together on what moved our EBIT performance you'll be familiar with most of the key drivers here, cost inflation, our mitigation against that, the impact of our capital plan, so our investment programme both last year and this year. In aggregate EBIT was lower down at £141m, but if I take out the fact that it was helped by Easter and then set against that the larger detrimental factors being basically snow, the fact that we're accelerating our capital plan and we made some disposals last year; we think the first half represents about a stabilised or a flat underlying operating profit performance which is the first time we've achieved that for two or three years.

Our cash flow was very strong. Net outflow was only £3m even after having paid £40m of bond amortisation. However, I do have to stress that that benefited by a £32m inflow of cash to working capital. Again, that's a non-recurring item and that really reflects the 53 week accounting year we had last year on our quarterly payments, particularly of rent, rates and VAT.

Group net debt continues to come down another ten basis points down to 4.1 times EBITDA. We're continuing to invest in our estate and if you remember this is one of the main pillars of building a balanced business. We've actually accelerated this year a lot of that investment into the first half. So our full-year guidance for capital spend of around about £180m remains unchanged but we completed 224 projects in the first half. That's a 25% increase from where we were this time last year. And returns remain strong, just under 20% on conversions and acquisitions and well over 20% on remodel spend.

So lastly before I hand over to Phil just a little bit of word on the dividend. You'll remember last November we said that we would not be paying an interim dividend and we're not. The Board will make an assessment at the end of the year in the light of a full year's trading and in the light of prospects as at that time. But just to reiterate some of the criteria that we talked about in November. We said then that we saw the prospect of very tough trading conditions ahead of us. I have to say some of those conditions have started to manifest themselves in the first half and you've seen that in the spate of CVAs in certain sectors of the market, particularly casual dining space. Our priority when we make that assessment at the end of the year will be to meet our outgoings, it will be to maintain the condition and the competitiveness of our estate, and it will be to protect our balance sheet which means not to see a structural increase in our unsecured borrowings on a short-term basis.

So we'll make that assessment at the end of the year. What I would emphasize is that whatever the distribution policy is whilst we do that we are systematically de-gearing this business. We retire about £80m - £90m of our bond debt every year. We're putting £47m a year into our pension fund which we would expect to be neutral full funding by 2023. So whilst we do that the equity base of this business does continue to grow ahead of the distribution decision.

So with that I'd like to hand over to Phil.

Phil Urban, Chief Executive

Thanks, Tim, and good morning ladies and gentlemen. Back in 1991 British Rail were pilloried for blaming their woes on the wrong type of snow. As Tim said we've had four bouts this year and that's certainly tested my resolve, falling every time on a Sunday certainly made it the wrong type of snow from our perspective. But like the World Cup we just see it as a blip on our journey; it doesn't change our focus or our belief that we are now making real progress.

As we've consistently said in these updates we remain focused on our three key strategic priorities which are rebalancing our portfolio, all about driving our growth brands, upgrading amenity across the estate and ensuring that each one of our brands remains relevant to the customer. Driving a commercial edge to the way we do business and putting innovation at the forefront of what we do. And these three priorities haven't changed and they keep us focused on ensuring that we make balanced progress that we can then sustain.

So what I'd like to do over the next ten to 15 minutes is to update you on the significant ground that we've been covering and hopefully get across to you why we are quite encouraged by what we're seeing. And then, as promised in the prelims, to give you a little bit more detail and content around the second wave of initiatives that we believe will become the engine room for this business over the next two to three years.

But firstly, looking at the market. There is no denying that the market remains tough. As Tim mentioned, you've seen the trade press, you know, CVAs, closures, which we predicted, and we expect that to continue, but it still only represents a very small percentage of supply. And the consumer, who is also under pressure, still has a lot of choice.

So we see the challenge as being one of a market share grab, and to do that you have to have great offers delivered expertly in great locations by great people. Hospitality is straightforward, but of course every operator is trying to do the same thing, so standing out requires constant evolution on numerous fronts if you're going to win.

Pleasingly for us, we have continued to trade well ahead of the market, as measured by the Peach Tracker on sales, which takes us to 20 or 21 months of outperformance. Now, as Tim says, without the snow we conservatively estimate our like-for-likes would have been in the region of 2.3%, which is obviously growth on growth for us.

Now, the chart shows that our outperformance probably started in about June of 2016, and has continued ever after, and we believe that came as a direct result of the first wave of initiatives which we called Ignite, launched in February of 2016. And that's one of the reasons why we're very optimistic about the second programme we're about to launch which I'll take you through, because there's no reason to believe that shouldn't have the same sort of positive impact on the business.

But what I'd like to do first is just update you on some of the things we've been doing that I think is driving our momentum.

Firstly, our focus on the guest and service remains paramount to all that we do. Following the introduction of reputation.com which I've spoken to you before about, which is our tool to communicate with and listen to our customers, we're delighted that our net promotor score stood at 61 at the half year, up from 56 the previous year, which is a big jump and a very positive lead indicator. 90% of all our social media content is now being responded to, up from 64% the same time last year, and I think is evidence that the organisation is now genuinely putting the customer at the heart of what it does.

Our online bookings now track at around 120,000 a week, which is up from 80,000 in half one of last year, and we see one and a half million people coming onto our websites each week. Again, an increase of 25% year-on-year.

We also have over 100 sites now live with Deliveroo and Just Eat, which drives a modest increase in profit and sales and profit, but more importantly, keeps our brands up there in our customer repertoires.

We have over two million guests who've downloaded our brand apps. We have a loyalty programme on trial and up and running in Browns, and our CRM capability is growing in sophistication by the day. All of these things, for me, are evidence that our digital focus and strategy is beginning to bear fruit, but we still have a long way to go, and it's this that makes me excited, because I think we're only just scratching the surface of the potential that we have.

Moving on to cost. Labour remains our biggest cost, and as I said at the prelims, the new labour rostering software and our time and attendance system that we put in last year is now bearing real fruit. Labour is the biggest cost in this industry, but we are in the service industry, so bluntly cutting labour is probably the wrong thing to do; you have to be quite scientific.

The new software has enabled us to target efficiencies in the right place and to deploy our labour budgets in an optimal fashion. Now, we've made great progress, but we think we can go further still if we can improve the sales forecasting at unit level. And I'll return to this as part of the second wave of initiatives.

Moving on to stock control. We continue to work on our auto ordering project for our stock system which we believe will save all of our businesses a significant amount of administration time, as well as improve our stock control, both in terms of product wastage and outages, and therefore in theory, drive sales too.

Now, we've taken a lot of learnings from the trial we've had, or the pilot we've had running in Vintage Inns, which saw product availability increase significantly, and we're now refining that process before we can roll out across the business. The sorts of things we need to give some more thinking to is how to handle substitute products and varying pack sizes.

However, we remain convinced that this, in conjunction with Prep and Par, which is the piece of software that allows our kitchen managers to prepare the right amount of stock for each shift, plus remote counting and bar coding, which will enable our businesses to take electronic stocktakes, which will be far quicker and far more accurate than the manual equivalent, all these things will step change our ability to control stock by saving time, reducing costs and increasing sales. And unsurprisingly, this remains one of our areas of focus under Ignite 2.

The other big driver around momentum is undoubtedly our capital. I think we've accelerated that capital programme this year. We've worked hard to reduce the cost of individual project types and reduce our closure time to a minimum. And as Tim said, in half one we completed 224 developments, versus 178 in half one of the previous years. Now, that obviously has a profit impact in the first half year from the closure, but we will get the benefit from here on in.

And we are now comfortably on our desired six to seven year cycle of reinvestment. Although we still have too many sites that are uninvested for over seven years, I think we are beginning to reach the tipping point in terms of our estate quality. Any drag that we've had on recent years by having an uninvested tail is now slowly diminishing. And the balance of our estate is now moving towards the premium end of our brands.

Now, as promised, we've also opened our hundredth Miller & Carter, which was the China House Vintage Inn in Plymouth. The Miller & Carter team have done a stunning job because they've managed to grow all their brand metrics at a time when they've grown their brand from about 30 two and a half years ago to over 100 today. And crucially, they've maintained the brand culture which that brand is built on. And we have plans to continue expanding Miller & Carter to 125 and beyond.

In addition to the core capital programme we also continue to drive new concept and new product development in the background. The two new concepts we launched last year continue to get unbelievable customer reactions actually. With Chicken Society we feel we have a food offer that we can drop into existing businesses, but for it to really work as a standalone business we think we need a really high footfall high street location.

With Son of Steak that business now turns over £20,000 per week plus, which now begins to make it a viable brand, but it will remain in incubation for the moment while we refine the offer.

But as stated last year, both these pieces of R&D were as much about breeding and promoting an innovation ethos across M&B and we have a number of new ideas in various stages of development that sit with our innovation forum and I'll update you more once we're ready to do so.

The hospitality industry is reliant on great people, and I'm a passionate believer that team engagement is the most important thing. So I'm delighted that our team engagement improved across every cohort of our business over the last six months.

Now, as Brexit outcomes remain uncertain, our main concern is access to EU talent, and we've already seen a reduction in applicants in front of house positions, and particularly back of house positions, which therefore makes our belief in an investment in our apprenticeship programme even more pronounced, as we believe this is the way we will develop talent needed to drive our business forward in the future.

Now, we already have an average of over one apprentice per business, with over 70% of our sites having recruited. We're able to offer a real career path to our apprentices, and we're bringing about 200 apprentices a month into the business, and we have the largest chef academy now in the UK. So we were delighted to win the Early in Career Development Award and the overall Best Place to Work Award at the recent National HR Distinction event.

Now, I share this with you, only because we have been very silent on our people agenda at these updates, but I believe it is more evidence of the solid foundations we've been putting in place quite quietly over the last couple of years that sets us up for a bright future.

So we believe we've stabilised our underlying profits for the first time in a few years, as Tim said. So focus is now on the next wave of initiatives that will take this business forward. Ignite 2 has eight buckets of activity, each sponsored by a member of my executive committee, and each led by one of our operations directors, supported by one of our senior functional experts.

Now, this is slightly different to the way we did Ignite 1, in that we've involved the operators far earlier at the outset which we believe will improve the richness and quality of the planning, but more importantly will really help with roll out when we're ready to do so. And we're already beginning to see some benefit.

Together there are over 43 separate initiatives, each led by a separate team of people accountable for delivering a defined benefit. By structuring the programme in this way, and by breaking down large areas into manageable work streams, it means we're able to cover a lot of ground simultaneously, and also engage many of the team from across the business in this programme of work.

But to give you a feel for the sort of areas that we are focusing on, the first heading is sales and service, and we have projects amongst other things looking at unprofitable hours. Another looking at getting our 40,000 colleagues we have in our business selling up. Another looking at addressing underperforming assets. And another also looking at raising our site standards. We believe we have a lot to go at in this space, and this will be a big engine room for us in the coming months.

Number two is labour. Under that, as I talked about earlier, we're looking at how we can improve our sales forecasting, because if we get the sales forecasts right then we can have our optimal rosters alongside. And we've also got a project looking at supporting those sites that are struggling to create an optimal roster for their businesses. As with Ignite 1, we intend to be very scientific about labour management. As we see it this is as much about driving efficiency and optimum deployment, and not necessarily about bluntly cutting cost.

Number three is stock control, which I talked about earlier. Number four is external spend, where we have projects looking at amongst other things cash spend in the business, further product rationalisation across brands, and reducing our maintenance costs further. One of our biggest strategic advantages is of course our scale, and we believe we have plenty of opportunity to leverage that further than we do today.

Number five is big bucket, which is menus and pricing, and we have work streams looking at things like menu psychology afresh, speed to market of menu changes, and more bespoke and radical tailored pricing if you like site by site. We want to be able to increase or improve our agility to be able to change price or menu content at pace, and so we're also thinking hard about our lead times and how we use our point of sale.

Number six is capital and ROI, where we're looking at amongst other things further value engineering opportunities, better site selection techniques, and a greater focus on poor performing investments. Our capital programme is beginning to become the engine room that it should be, and given the fact that we intend to continue spending around £160-180m a year, it's clear that any progress in this space could be quite material.

Number seven is a huge area which is digital marketing, where we have several projects looking at setting M&B up for a digital future. We have work streams designed to improve our CRM effectiveness, another looking at rolling an order at table out across our businesses, another looking at optimising our third party delivery partnerships. The point here is that technology is moving so quickly that we don't know what we might need tomorrow. But what we can do is prepare ourselves to be able to embrace new technology far more quickly than we're able to do today. And that's what this whole area is looking at.

And finally, and certainly last but not least, is stock and cash leakage where we are a long way forward in terms of improving our controls around stock and cash management, which we believe can be a sizeable benefit. As we've moved into a digital age, and with the explosion of virtual voucher codes and multiple till transactions, it becomes far harder for manual supervision to really monitor what is going on. So we've been trialling software designed to pinpoint weakness in controls, which then help our general managers to quickly resolve them. As the cost headwinds continue, we believe this programme of work will not only mitigate for these costs, but will take M&B back into profit growth.

So, in summary, we are pleased with the progress we've made. More pleased than the market is this morning, but we're pleased with the progress we've made. We are an 82% freehold business that continues to pay down its securitised debt and pension liabilities all the time. We have a strong portfolio of brands and a detailed change programme that will see the business innovate across a number of fronts. I think the business is well placed to accelerate the generation of sustained shareholder value. The market remains tough, costs unrelenting, but it's still a very big market, and so the operators who continue to innovate and who can consistently provide great hospitality, will win. And we intend to do just that.