Mitchells & Butlers plc
Pre-close trading update call
26 September 2013

Presentation

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Good morning everyone, and thank you very much for joining the call. And I know it's a particularly busy day today, so I'm sure you've got a lot on your plate. I've got with me Tim Jones, our Finance Director, and the two of us will be happy to take questions after I've done an introduction to this trading update.

So we've announced a trading update this morning covering the first 51 weeks of our financial year to Saturday 21st September. Margins were up in the second half, and we've said on the statement that we expect to deliver a result for the year in line with the Board's expectations.

In the period we recorded sales growth of 2.1% and like-for-like sales growth of 0.4%. Now, like-for-like sales in the fourth quarter were 1% lower than last year. We're up against a strong comparative performance last year when we were ahead by 3%, and for most of the last quarter our like-for-likes were in line with our expectations.

What has happened is that there's been a noticeable drop-off in trade in the last three weeks of the period, namely the beginning of September, and we've seen some evidence from some of the data we've got that we are not alone. It's worth saying that that slowdown in September is across all of our brands, so it's not specific to any particular brands. And we know from the weekly Peach tracker numbers that we get, that aren't detailed externally, but we know that we're not alone in terms of some of that downturn in September specifically. It's also worth saying that we are of course the first company to report on trading in September after the August bank holiday, so it's going to be interesting to see what others have to say in due course.

Looking forward to next year we expect our sales to build. We've got plans that will, that are designed to do so, but I think it's just worth saying that we continue to be of the view that the economic recovery is going to be patchy so you should continue to expect to see highs and lows. Increasingly we're seeing in the market that consumers are going out less, but when they do go out they spend positively and are looking to have a good time, but it does mean that we're going to have strong months and weak months, and that's our view on what's going on in September.

And it may be that what is happening is that after a pretty good summer consumers have spent perhaps quite a lot on credit and what they're looking to do at the moment is just rebuild their personal finances for a short while. None of this changes our strategy of focusing on a balanced approach to like-for-like growth, so we're very keen and we are maintaining investment in service and managing our margins, and the margin story is a success for us in the second half.

Against our original expectations of delivering flat margins year-on-year in the second half, as cost savings that we created last year annualised and lower opening costs dropped away, we've actually managed to deliver improved growth and operating margins throughout the trading period, which is a good performance.

The other really encouraging thing is that these improvements have not come at the cost of investment in the transformation programmes we've been working on around guest-facing service and other investments in systems, and we think it is more important than ever to continue progress on those fronts where you have consumers who, every day, get more demanding about what they expect to receive when they go out.

So overall we're confident at delivering a full-year result in line with the Board's expectations and we think it's a good result given the fact that we've also been going through... continuing to go through a significant transformation programme.

Just one final word on capital expenditure: we've reiterated our medium-term aim to open 50 sites, new sites, a year, in our most successful brands. As you know, we are looking primarily to drive our efforts behind Toby, Harvester, All Bar One, and Miller & Carter. We've done 22 significant projects this year and we certainly see that rising next year as our pipeline builds. We're not going to get to 50 next year, but we certainly expect to be ahead of the 22 we've completed this year.

So I hope that's all proved useful. We'd be delighted to take any questions now.

Questions and Answers

Jamie Rollo – *Morgan Stanley*

Yes. Hi, morning, everyone. Three questions, please. First of all, I'm just wondering how much of a tough comp the period was, because I thought the 3% growth last year was more due to the easy comps the prior year with the London riots. So if you look at the sort of two-year change it does look like there's a bit of a slowdown.

Secondly, I'm just wondering what you think your performance was relative to peers. I guess you can't give the September comp, but in the sort of, perhaps in the month of August if you can give us that?

And then finally, I'm just wondering, given the strong margin performance in H2 on sort of tougher comps, what does that mean, you think margins can do for 2014, if we assume sort of still modest top line? Thank you.

Tim Jones – *Mitchells & Butlers – Finance Director*

Hi, Jamie, it's Tim here. In terms of sort of two, three-year comps, we're obviously getting into quite a lot of detail here, yes, there were riots two years ago; they will have affected a couple of weeks in that. Probably the best way to look at it is to step back and look at the four quarters on a two-year comp basis, and if you look at that, then we're about 4% up in the first quarter of this year, about a per cent and a half in the second quarter, and we were running about 2% up in both the third and the fourth quarters. So that would indicate that there hasn't been a significant sort of come-down on that basis. Beyond that I think, you know, we can keep going back as many years as we like, it's a bit difficult to know what to read into it.

In terms of peers, you know, our August numbers were fairly comparable to a lot of the announcements that our peers put out around the end of August, certainly the strength in London, all the messages they were giving. In terms of what's happened more recently in the last three or four weeks, our best handle on that is the Peach tracker which Alistair referred to, and what we're seeing is certainly reflected in, and consistent with, what we're seeing coming through from the Peach tracker numbers.

I think your last point was on margin. You know, we had a good second half margin performance. I think as we go through to next year we would hope to be able to hold that full-year margin that we're going to report for FY14 about flat, based on, you know, an increase in like-for-like sales growth over what you're seeing for this year and a lot of the self-help and initiatives that we've got coming through.

Jamie Rollo – *Morgan Stanley*

Great. Thank you very much.

Operator

Your next question comes from Lena Thakkar from HSBC. Please ask your question.

Lena Thakkar – *HSBC*

Hi, good morning. Two questions, please. Firstly, on the underlying sort of number which you spoke about if we remove September, I suspect that's still around 1% you're referring to?

Tim Jones – *Mitchells & Butlers – Finance Director*

Yes, that's correct. Yes.

Lena Thakkar – *HSBC*

I mean, I guess that's, well, I hope that's sort of unsatisfactory anyway versus peers and, you know, versus what you'd hope to grow in the sort of UK market. I'm just wondering where you expect that 1% to go in the medium-term and, you know, when some of the initiatives will, sort of, lead you there. And then the second question is just if we could have an update on the triennial review of the pension. Thank you.

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Yes, well, I'll hand… I'll let Tim take the triennial review position on the pension, but just as far as like-for-likes go, so, yes, your underlying 1% is where we're at and that's what we've been talking about now for quite a while. It would be fair to say that our plans for next year, we would like to see our like-for-like sales move forward from 1% and we're planning to do so.

Equally, and I'd just reiterate the point that our plans are still based on the principle of building long-term sustainable growth through guest service, and what we're not going to do is accelerate like-for-likes by increasing our promotional activity, for example. So our promotional activity is pretty flat year-on-year, we think that's the right thing to do, and we're not convinced that doing excess activity to grow our like-for-likes aggressively is going to be good for margin. So we want to make progress next year, but we want to do it in a sensible, sustainable way.

Tim Jones – *Mitchells & Butlers – Finance Director*

In terms of the pensions position, Lena, frustratingly we don't have anything definitive we can give you today. We're spending a lot of time with the trustees, but we're not yet at the stage where we have an agreement with them on either the quantification of the deficit, nor how we would fund that. And I guess the obvious question is, do we expect we will have an agreement by the middle of November when we do our prelims? I think that's possible, but probably unlikely from where I'm sitting today.

The only other relevant factor, as a number of you I'm sure will have noticed, is that real gilt yields have recovered fairly substantially in the last few months. That is helpful for us, although it doesn't change the valuation date. Our valuation is struck at the end of March and it's conditions at that date, on that date, that determine the core objective inputs into the deficit, but it does of course, as a backdrop help us to argue that that represents, if you like, an abnormal market position or something which we need to have an adjustment for. So very helpful what the market's done subsequent to March, but there's no automatic path for that to feed through.

Lena Thakkar – *HSBC*

Okay, thank you. And Alistair, if I could just follow up on the first question? I totally take your point about not just wanting to drive like-for-likes, but could you tell us perhaps what the main metric is? Is it, you know, a profit per pub? Is it a sort of ROCE number? What are you really aiming to drive forward?

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Okay, well, I think it'd be worth going back to the key part of the, one of the key parts of the presentation at the half-year, which is that in order to create this balanced transformation of the business we are focusing our efforts on four priorities. So if you take our first priority, which is people, we measure every single period how we are doing in terms of reducing retail staff turnover, so that's a key measure for us.

We measure, when it comes to practices, really important things like, are we improving our scores on the doors, because we see pubs getting high scores on the doors as being beneficial for trade and we want to run safe, efficient premises, so we measure that. And when it comes to guests, of course our key metric is net promoter score.

Now, it’s worth saying that on… in terms of these leading indicators, so if you take retail staff turnover for example, we have made progress over the last half year, which is great. So retail staff turnover is dropping, and net promoter score is up four or five points on the same period last year.

So all of these are, we believe, lead indicators that lead ultimately to like-for-like sales improving, but it’s a competitive market. We know that we’ve got some… there are a number of strong competitors out there, so we’ve just got to keep working away at that in order to see it flow through to improvements in like-for-like sales.

And of course what we are seeking to do is to grow like-for-like sales, we’re seeking to improve returns on expansionary capital, and we’re seeking to continue to drive profit forward. And I think the encouraging thing for us is that, I would reiterate, in the year where we’ve been very busy doing a large range of transformational activities, many of which will continue into next year, we have made, you know, our profit result will be in line with the expectations that we set with the board. So that is a good result, as far as we’re concerned.

Lena Thakkar – *HSBC*

Okay, thank you very much.

Operator

Thank you. As a reminder, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. Your next question comes from Jeffrey Harwood from Oriel. Please ask your question.

Jeffrey Harwood – *Oriel*

Yes, good morning. Just a quick question: in terms of trading by region, have you seen any change there, like presumably London is still way above the rest of the country?

Alistair Darby – *Mitchells & Butlers – Chief Executive*

I’ll let Tim take that.

Tim Jones – *Mitchells & Butlers – Finance Director*

That's absolutely correct, Jeffrey. We're certainly seeing quite a marked spectrum of performance across the country by region. I think the only thing I'd temper that is, you know, what's happened in the last two or three weeks, that that has not been restricted to one or a few particular regions; that has been something we've seen pretty well across all of our regions. So whilst that differential has been maintained, the impact of the couple of weeks has been more widespread than that.

Jeffrey Harwood – *Oriel*

Sure. Okay, thank you.

Operator

Thank you. Your next question comes from Douglas Jack from Numis. Please ask your question.

Douglas Jack – *Numis*

Hi. So, talking about the margins it sounds like the margins guidance for next year is flat on the basis that half two 2013 was kind of similar to half one. If that's the sort of outlook for next year, what kind of cost pressures are you expecting to come through next year, and what sort of level of like-for-like sales do you need to hold margins flat on the basis of that level of cost pressure?

Tim Jones – *Mitchells & Butlers – Finance Director*

I think, Doug, I think our cost pressure will sort of blend out around 2 to 3% across, you know, across wages, across utilities, across food price inflation, etc. And I think obviously we're anticipating stronger like-for-likes than we're going to be reporting for FY13, so we think that they should drift up to around, you know, 1.5, 2%, something of that order to allow us to maintain the same margin.

Douglas Jack – *Numis*

Okay, thanks for that. In terms of expansion, how many units do you think you'll open in 2014? I'm not assuming you're going to go straight to 50 sites in the first year.

Tim Jones – *Mitchells & Butlers – Finance Director*

No, that's right. I mean, 16 this year and we think maybe 30 next year, something like that in terms of new sites. And then, you know, we'll build up to that 50 that we've quoted externally, you know, the year after that or subsequent.

Douglas Jack – *Numis*

Okay, and in terms of the expansion, what gives you the confidence to step it up a bit? Because you have underperformed historically in leisure parks, you haven't really hit the target returns you were hoping for originally, obviously some of that was down to Toby, but what's right about Harvester now that Harvester can now take on the likes of the Restaurant Group and perform a lot better than it has done in the past and makes you ready to really expand that brand?

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Okay, I'll take that one, Doug. You won't be surprised if I keep my powder fairly dry on this one because I'd hate to give you all our top tips. All I can say is that we're confident that the vast majority of sites we have opened over the last few years are good sites. The challenge was that we opened a lot of sites in a very short period of time and, in hindsight, were not operationally geared up to open those sites as successfully as we'd like.

We're much better placed now than we were on that front. We've learnt a lot of lessons, which is very helpful, and we also have learnt a lot about some of the important operational differences about running a Harvester on a leisure/retail park versus running a Harvester in a suburban location. So what you're going to see is and, you know, we'll let you visit a few of them in due course, you will see us making appropriate tweaks to the Harvester offer in those locations that we are pretty confident will make a difference to sales.

So I'm probably not going to say much more on that because I would hate to have everybody running around seeing what we're up to, but we are really confident that we know what needs to be done. And I think that the thing that's made a big difference, Doug, is that the consumer research that we've been doing over the last year has been very, very helpful in directing as to how we can raise returns. So that's probably, if you'll forgive me, as much as I'm going to give you on that one.

Douglas Jack – *Numis*

Okay. No, that's great. Thanks very much.

Operator

Thank you. Your next question comes from Peter Winning from Aberdeen Asset Management. Please ask your question.

Peter Winning – *Aberdeen Asset Management*

Hi there, just one question from me, actually. I saw recently that some pub companies are looking to effectively do some kind of VAT boycott to, in an attempt to boost sales. Is Mitchells & Butlers part of this group of pubs and do you know, you know, which of your competitors might be involved?

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Okay, so there was a big event yesterday. A number of companies, including JD Wetherspoon, reduced prices by 7.5% for one day yesterday to highlight the VAT differential between VAT that's applied to food in pubs versus to VAT sold in supermarkets. So most food in supermarkets is zero VAT whereas food sold in pubs is 20% VAT.

So a number of companies participated in that campaign. I'm not quite sure how many pubs in total. There was some talk of 15,000 but I can't verify that. We're not part of that particular campaign. We support the idea. We'd be delighted to get a VAT reduction, but at the moment our lobbying efforts are very much around trying to encourage the government to undertake broad measures that will stimulate employment, because the more people that are working, the better that will be for us as a business, so more cash in pocket.

And what we do is, we're very big supporters of apprenticeship schemes, getting young people into work through pubs and so on, and clearly we have an expansion programme as well and every time we open a new pub we're probably employing 30 to 40 people in that site. So we think those are all initiatives that are really good for employment and we think will represent a good story for government.

And we do recognise that as much as we'd love a VAT reduction, the kind of VAT reduction that's being sought would represent a pretty big ask for the government for this particular sector. So, you know, good luck to the VAT group and if they can get a VAT reduction, we'd be delighted, but we're pursuing other measures to encourage the government to work with us.

Peter Winning – *Aberdeen Asset Management*

Okay, thanks.

Operator

Thank you. As a reminder, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. Your next question comes from Tim Barrett from Nomura. Please ask your question.

Tim Barrett – *Nomura*

Good morning, everybody. I was a bit late on the call so apologies if you've already been through this, but have you talked about the like-for-like growth in the fourth quarter by format type, specifically whether the value sites are still lagging the family and special segments? And possibly related to that answer, is there anything to call out in terms of the stability of food versus the decline in drinks? Thanks very much.

Tim Jones – *Mitchells & Butlers – Finance Director*

We touched on it, Tim, basically to say that, you know, whilst there are differentials in performance across both region and format, the slowdown, if you like, that we've seen in the last two or three weeks hasn't been restricted in any way to just one of those. It's been much more widespread. So, yes, value is an area that we've spoken about in previous conferences that we're working on very hard as, to drive forward our like-for-likes after our performance [...] but that hasn't been more acute than anyone else within this [...].

Tim Barrett – *Nomura*

That's helpful. Okay, thanks.

Tim Jones – *Mitchells & Butlers – Finance Director*

I can’t remember what your second question was.

Tim Barrett – *Nomura*

Just in terms of the drinks decline in the fourth quarter.

Tim Jones – *Mitchells & Butlers – Finance Director*

I don’t think there’s anything specific we’re reading into that, certainly not across the brands. I mean, you know, drinks did pretty well in the comparatives with the weather so it’s come off slightly, but I wouldn’t see it as anything more than that.

Tim Barrett – *Nomura*

Okay, thanks for that.

Operator

Thank you. Your next question comes from Simon French from Panmure. Please ask your question.

Simon French – *Panmure*

Yes. Morning, guys. Like Tim I was late on the call so I would appreciate it if you could just sort of reiterate some of the messages around the slowdown in like-for-like sales in September. And I think you said it was consistent with the Peach tracker numbers, but clearly you’re a large proportion of the Peach tracker so that would imply that the peer group is growing faster than you.

And then also on the margin, I think to sort of hit consensus numbers based on total sales growth you’d need the margin to be up about 40 bps in H2, as well as the 40 bps achieved in H1. Could you just sort of confirm whether that’s the case, please?

Tim Jones – *Mitchells & Butlers – Finance Director*

Your arithmetic, Simon, on the margin is right so that's correct. In terms of the last nine weeks, again I'd reiterate, you know, we're seeing differential performance across the estate, across brands, across regions, but what we've seen in the last sort of two or three weeks has not been restricted to any one of those.

I think it's perhaps helpful for you to, all to understand that those nine weeks were not a generic performance period that ran at minus one through nine weeks; it was actually in line with our underlying sales of plus one for the six of those nine weeks, and then we've had a fairly marked turndown at the end of that.

There's also the point that the bank holiday moved for us and a number of our peers which will be contaminating a lot of the stuff which we're trying to compare to, which is difficult, but here you've got a like-for-like performance.

Peach, I mean, because we're only talking about a three-week period it's difficult to get corroborative evidence. We are seeing a downturn in Peach. Peach was negative and our performance is comparable into that. I guess you can just read into that whatever you like.

Simon French – *Panmure*

Okay, and then, sorry, just following up then on next year sort of, you know, like-for-like sales in the first half were up 0.3 or up 0.4 for the full year. I don't really understand where this confidence comes from that you could be growing at, say, 2% next year. I understand the comments about reduced staff turnover and higher net promoter scores, but clearly your sort of, your exit rate, if you like, for FY13 doesn't really give confidence to the market that you can hit those kind of growth rates, does it?

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Well, I think, Simon, our view is, and I really reiterate the point I made earlier to Lena, which is that we're in the business of building long-term sustainable growth, and I know that may kind of be a boringly repetitive message but it is very, very important for us. We're a very large business; 1,600 pubs with a very high average weekly take which is above the industry average, so moving our like-for-like sales forward at 4 or 5% is going to be pretty difficult off the base we're coming.

And, as I said to Lena, the only way really we could match, you know, some of the like-for-likes being claimed elsewhere is by fundamentally upping the promotional ante in our business when we already have very busy pubs, and we are just not going to do that because we've got a good margin base and we want to advance that margin base, and we want to get the benefit of steady like-for-like sales growth flowing through to… and getting an operational gearing effect.

And we will do that by focusing all our effort on the development of people and the, kind of, efficiency of our pubs so that we do a great job for guests, because if we can get guests coming back and recommending us that will feed into quality like-for-like sales growth. And by quality like-for-like sales growth I mean, perhaps a lower lick than some other people, but with good margins and good profit flow through.

And we're confident that the initiatives we've got underway, the consumer insight we've got, and some of the technology investment that we're doing and our plans for capital investment will feed through in the coming year.

Simon French – *Panmure*

Okay, thanks very much.

Operator

As a reminder, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. We have no further questions at this time.

Alistair Darby – *Mitchells & Butlers – Chief Executive*

Right. Well, thank you very much, everybody, for coming on the call. I know you've got a busy day so I'm sure you're keen to get back to your desks. Speak to you anon. Thank you.