Mitchells & Butlers

Mitchells & Butlers Half Year Results
Thursday 23 May 2013

Q&A Session

Question 1
Lena Thakkar, HSBC
Morning, Lena Thakkar from HSBC. If I could ask three questions please. Firstly on the trends you are seeing between price and volume - obviously losing volume and gaining price - it seems that in the industry generally, consumers are actually, from some of the data I have seen, eating out more but spending less. Why are your trends opposite to this and what work have you done to understand that market or are you pricing too high? That's the first question.

Secondly in terms of capex, I was under the impression you were moving away from a specific target of number of pubs, you seem to have bought back in for next year. I thought there was a risk that if you tried to hit numbers that tends to end in perhaps some lower quality choices. Perhaps you can update us on your thinking there?

And finally, Alistair just on your presentation, I wonder if you could give us some more tangible targets in terms of where you expect like-for-likes to go, margins, returns and whether you will look to perhaps exit any of the underperforming brands?

Alistair Darby, Chief Executive:
Okay we will do a bit of a double hander on this. Tim which did you want to take?

Tim Jones, Finance Director:
Your first point was around people eating out more and spending less, was that right? Yes. Well, I am not sure that is what we would agree to having seen. What we tend to see is people are protecting special occasions: Valentine's Day, Easter, Mother's Day, and spending more when they go out on those special occasions. So it is a bit difficult to respond because I don't accept that, that is not what we see. We see people going out less but spending more when they do go out less. An easy way to look at that is the volume that I talked about there is the number of main meals we serve. Another way to measure volume is the number of items, so you will include starters and desserts basically. Our number of items is a far smaller decrease year-on-year. So proving much more resilient. And that is because whilst people are coming out less, buying less main meals, when they are coming out they tend to have a starter more than they used to or a dessert more than they used to. So that is really what we are seeing. There are wide regional variations around that and there is also wide variations between income groups so as I mentioned in our value brands, Crown and Sizzling and Oak Tree, getting much steeper sales and volume decreases than in the middle market brands.

Alistair Darby, Chief Executive:
Let me take the capex one. I was slightly kind of nuanced in what I said and what I think Tim said was that we want to move to a position where we are spending a large amount of money on expansionary capex and we will expect that to build over time. Certainly we would like to be in a position where we think we have the capability of expansionary pipeline, or sorry, being able to open 40-50 pubs a year over the medium term. It is very important though to remember that we have got some clear breaks on that. The first is that we remain absolutely committed to returns. So if we are not happy about returns we will always pull back on the accelerator. The reason why we are confident about the expansionary pipeline beginning to move back up again is that we are very clear about which brands we are interested in. We have got very clear consumer focus and we think that the brands we have identified, there is space in the market for them to grow. So that gives us some confidence on those. But what we will always do is ensure that we are going for quality. And I think if at any point we felt that we were getting back to the previous situation where we were chasing numbers - we are not going to do that - we would pull back immediately because we are not going to repeat that mistake. But I think the confidence that the consumer research has given us, the transformation programme and the scale of the business and the quality of our brands, then it should be feasible to expand on a larger basis over time, but we are not going to throw returns out of the window. Been there.

Tim Jones, Finance Director:
Your observation is exactly right, that we have said that we don't want to have a target for the number of openings and be held to that target. And we tried to find a balance here on being helpful and give you some range on roughly where capex will be, but if it is not right to spend it, we are not going to be embarrassed to come back and say we have under spent it, if it is right to under spend it. It is just to try and be helpful on roughly where it might settle on a trend level.

Alistair Darby, Chief Executive:
In terms of the third question to do with targets, I think what I would say is that I think setting a like-for-like target is just... who is going to do that? And the reason I say that is first of all, trying to compare anybody's like-for-likes is virtually impossible now and there are all sorts of cuts, timing cuts for like-for-likes, people are reporting estates differently and so on. I think what we are keen to do is just to, over time, ensure that by delivering better service, our like-for-likes are comparable with equivalent businesses that are doing a good job. Now what do I mean by that is, we are not going to go out and buy like-for-like sales by discounting this business because that would be contra to a protection of margin position. We want to deliver like-for-like growth that is high quality and compares well with other people who are delivering high quality like-for-like growth. We have some way to go on that.

As far as margins go, we have laid out a position that we want to protect and expand where we can. And that again will depend very much on the economic circumstances. Margin is a combination of blending. Can you grow price but how is the consumer feeling? This is always going to be a bit of a moving feast, but certainly we want to hold and improve the position, we don't want to do backwards. And returns we have said we want to improve returns, 17% is okay, but some of the comparators produce better returns, we would like to continue to move those up. I think the key thing for us is that when you look at our progress you should judge the trajectory and are we moving in the right direction because it is going to take some time.

Question 2

Jamie Rollo, Morgan Stanley

Jamie Rollo from Morgan Stanley. I am just looking for a bit of help on the pension and dividend questions please. Just on the pension, could you just give us a rough feel for maybe the upside risk on that £40 million of cash cost, could it be materially above £50 million let's say and is there any way you can mitigate that through ring-fencing assets or anything like that?

And then moving onto the dividend question, it sounds like a final, perhaps, is not likely this year given the recent bond yield moves. Could you perhaps talk about, you mentioned cash cover: is that post expansion capex as well as that £30 million of IT spend? And also what sort of level of cash cover are you looking for please?

Tim Jones, Finance Director:

Okay Jamie. Yes there is upside risk on that £40 million, of course that will depend not just on the deficit, it will depend on what period we are able to get the Trustee comfortable we can repay whatever the deficit is. So there are a number of variables that fall into that and it would be rash of me to come out with a number for you. But it certainly could go beyond £50 million in certain scenarios, I don't know. You saw from the gilt yield chart that I put up that gilt yields have moved about 150 basis points over the last three years. You know, because we tell you, that we have a sensitivity of £36 million to 10 basis points. You know that we put £120 million into that fund over the last three years and you can take a stab at what asset returns are because you know where we are investing, broadly. So that can give you a sense of roughly where the deficit may end up and that could be the wrong side of £600 million from our perspective, I don't know but it could be. And then once we have settled on that capital sum we need to then work out how we are going to repay it and what the recovery profile is going to look like, but there is material upside risk on that, but I just can't really give any more definition, because I am trying to call a negotiation and probably they are listening as well, all the people I am going to talk to, but yeah it is a volatile situation.

Jamie Rollo, Morgan Stanley

Assets?

Tim Jones, Finance Director:

Well the thing is most of our assets are in the securitisation unfortunately. So the expansionary capex we are doing at the moment is outside of the securitisation, but about two thirds of that is leasehold so a fit out with retail environments, so it doesn't really lend itself so well as a collection of freehold pubs if you like in terms of securitisation. No, the scope for that is minimal unfortunately.

The second question was about dividends and as you said, yes gilt yields are a part of this equation, so they are going to frustrate that equation. How do we look at it? As I have always said, it is not a balance sheet issue for us, we need to be comfortable that we can cover our in-year cash demands, our cash fixed charges and generate a surplus. And from that surplus we will look to distribute and start a dividend. How do we look at that? Well yes certainly post expansionary capex, you know and we also have to be mindful that we have to pay down £50 million of bonds every year. And one can argue whether that is cashflow or not. But in the first instance it absolutely is a cashflow because we have to write a cheque for it to our bond holders every quarter. Now maybe we can replace that with fresh debt and it all washes through, but it is something we need to be mindful of. So the slide I had down on there earlier on ran you through if you like, everything that comes into consideration and that was positive in the first half, it was plus just over £40 million in the first half. What we need to do is look at the long-term level that those lines in that equation are going to settle at in terms of pension, in terms of expansionary capex. Expansionary capex, I have given you I think some definition. Pension, I am not in a position to do that unfortunately at the moment.

Question 3

Tim Barrett, Nomura

Tim Barrett, Nomura. Two things please. First in terms of volume. You talked about the decline being a lot better in the upper end of the estate than the value end. And it seemed to imply like a double digit decline in value food volumes. That I think is a scale model and your predecessors used to talk about that a lot. So are you doing things to address the volumes in the value end?

And secondly a question on the scale brands following your market work. I know you don't want to give an annual openings figure, but some of your brands, most of your brands are less than 200 sites, where do you think the best ones could go to? Thanks very much.

Alistair Darby, Chief Executive:

We are not going to answer the second question because I just, we don't want to get hooked on numbers. In the end returns and guest appeal and availability of sites will drive the ultimate size of those brands. We are confident that they can get bigger, they are sitting in attractive market spaces and we would be disappointed if they didn't make progress. But in terms of setting ourselves specific targets we are not going to do that. I think we learnt that mistake from a few years ago. And we are really concentrating on how do we role this out in a quality, high returning way.

As far as volumes go, I think the clue really is in the trading strategy that we identified for Heartland particularly, which is about protect and compete. I think we are the first to admit that to a certain extent a few years ago, and Bob has talked about this, there was an over aggressive drive towards food and the value end of our estate and we are trying to address that now by doing a number of tactical things like putting Sky back in, making the pubs feel more drinker friendly than they were and that is work in progress and we have seen some encouraging signs from that.

So we have got to compete harder because in some instances we have been out manoeuvred and we have been the first to admit that, but we are working on that and making progress.

The other point though is that this market is all about amenity is important, so your pubs have got to be clean and tidy, but the absolute prime driver of success is value. Value is everything. And that literally means the benchmark price for a carvery meal or a burger and chips. What is really crucial though is that you get the combination of great price point but actually make some money out of it.

So out view would be, and you are kind of seeing it in the margin improvement, some of the volume we have ceded at the value end has had a relatively small impact on profitability and that comes back to how do you get the sweet spot? Fantastic consumer value, but you are not just doing it for fun. And that is a bit of the story at the value end of our market. But what is absolutely critical is protect and compete. We have a large estate of pubs, they generate a lot of cash for us, sit in great locations, and we have got to get that absolutely great combination of value and amenity. So we are still working very hard on that.

And the final point I would make on this is that you have also, as a result, got to run these businesses very efficiently. So you don't want bells and whistles in these pubs when fundamentally what your consumer wants is £4.19 carvery meal.

Tim Barrett, Nomura
And have you got a figure for expected spend per pub if you are turning off the capex to that end of the estate, maintenance capex per pub?

Alistair Darby, Chief Executive:
We have an annual operating standards programme that would probably net out at about £40,000 a pub and that is making sure that the pub stays in good nick, tidy, comfortable, seating isn't ripped and so on. And that would be ongoing. That is why I said, ultimately we might not be spending expansionary capex here we would certainly continue maintenance capex. Because maintaining amenity in your heartland estate is very important. You know value is important, equally your customers will get upset if the pub starts to look riffy.

<u>**Question 4**</u>
Geof Collyer, Deutsche Bank
Geof Collyer from Deutsche. Three questions. Just following immediately on from that. Given that you are going to be more selective about where you are going to invest, does that change how you actually roll out the ways of working? Does the protect and compete end mean that you need to put your ways of working properly in there first to make sure that doesn't fall any further?

Secondly, can you give us some kind of steer about where the margins are per brand and would it be sensible looking at that or reasonable looking at your star to assume that the three points at the top of that star have higher margins than the ones at the bottom. So therefore if you are going to invest in that area, by definition that should mean that your margins should probably grow rather than stabilise?

And then thirdly, we have seen pretty strong like-for-likes at Young's this morning, can you give us a steer about the proportion of your estate that is in London and the South? Thanks.

Alistair Darby, Chief Executive:
I will let Tim pick up the like-for-likes in London, Tim?

Tim Jones, Finance Director:
Yes about 20% of our estate is in the central area of London and about 40% in London, greater London and the South-East. I referred to whide regional variations that we get in our like-for-like sales growth. In the last five weeks the total of our estate in like-for-like sales growth 1%, London was clearly into double digits. In the first 28 weeks we were 0.3% across the whole estate and London was in excess of 5%, close to 6%. So that gives you if you like a sense of how it outperforms the averages you see.

Alistair Darby, Chief Executive:
As far as ways of working goes, ways of working has already been rolled into Sizzling Pub Company for example as part of that 300 pubs that we are working on at the moment. We see ways of working being a cultural programme that will affect every single one of our pubs. Because in the end if fundamentally what we are trying to do is encourage pub managers and their staff to do a better job for guests, that will apply from a Sizzling Pub all the way to a Browns Restaurant. Sure, the guests may want something different, but they will still want teams of people who are doing everything

they can to improve the guest offer. So we see ways of working touching all parts of our business. And would we accelerate ways of working in some parts of the business faster than others? Well no, we would rather not do that, we think that would suggest that we have a two speed approach to this which we don't. This is a culture programme and it goes throughout the business.

As far as margins per brand go, I am not sure I would entirely agree with the assertion, actually, because marginally it is heavily driven by the amount of food you sell and now of course if you are selling food at a high price you will be making good margin. You can sell a lot of food at low price and make less good margin. And clearly you can have businesses where you sell a lot of drink and if you sell a lot of draught drink your margins will be very attractive. So it is actually, we would not see the kind of margin differential between brands that you think might exist because that is not actually the case. Because in the end, various things compensate for each other. So Sizzling Pub Company for example has got a very attractive margin structure because we sell a lot of draught beer. Expanding into those brands we are talking about in that top half of the star is not necessarily going to specifically drive margin up. We think the efforts we are making across the whole business and purchasing efficiently, building guest satisfaction will in totality affect margin. We don't have a margin specific expansion plan if you see what I mean.

Tim Jones, Finance Director:
I think we can say, just to put it right, that the point that has the highest margin would be upmarket social: particular Castle and Nicolson's, and where you have got London based pubs selling a lot of drink, make bigger margins than food based pubs that are regional.

<u>Question 5</u>
Nigel Parson, Dryburg Research
Nigel Parson from Dryburg Research. A couple of questions. Is your organisation structure right to deliver your renewed focus in terms of strategy? Should we think of any exceptionals or any changes coming through?

And secondly is the IT spend in addition to your capex or is it wrapped up within that capex number?

Tim Jones, Finance Director:
Actually in exceptionals, I don't see any exceptional coming. We did a root and branch review of the organisational structure which resulted in the £10m savings we have got now. We are not going to keep chipping away, we need to get on and run the business and grow the business. So there are no restructurings imminent and I don't see any exceptionals related to that either and indeed this IT spend is not an exceptional. We will report the capex of that and the operating costs and one off costs of that within our normal earnings.

Will it represent an increment above our normal maintenance spend I think was the next question, I think it probably will. I think it will be misguided of us to cut back on maintaining the amenity level in our pubs because we need to put in the new till system, if that amenity level was required to trade well. So I think they are separate decisions and wherever we end up on point of sale systems, I think we have to see that in increment to what is the right level of capex to spend on amenities and expansion and what have you. I don't see a link between the two and I think it would be dangerous to play them off against each other.

Question 6

Simon French, Panmure Gordon & Co

Morning, it is Simon French from Panmure Gordon. Two questions from me. Firstly can you give your latest view on cost inflation, particularly food and utilities?

And then secondly your plc cash is accumulating fairly rapidly, what are your latest thoughts on how you could use that?

Tim Jones, Finance Director:

Yes in terms of cost of food inflation, we are doing very well on food. We are seeing at the market, food inflation is probably still around 3%. We are achieving, an achieved inflation in terms of buying and what is going into the COGS of our menus at a lot less than that, that is closer to 1-1.5%. Energy is an increasing cost for the year, this half and it will be for the full year as well, probably 5-6%, something like that. A bit difficult to call the rest of the year. So the cost headwinds are pretty much the same, food is probably slightly more benign, or we have done slightly better than when we sat here in November when we were talking to you about what we thought that would be.

In terms of the plc cash, you know we do need to look at the Balance Sheet holistically. A lot of people tell me we are net cash - we are not net cash, we have got £1.8 billion of debt. It just happens to be that they are not played off against each other, which I accept leaks value. We have looked at options and I think we have talked in this room before about buying back bonds, about putting it into the pension fund, the fact we can't return it all to shareholders without significant restrictions on what we do with that. We have ambitions to grow this business and we are building a very stable platform as Alistair talked you through on where we are going to go it and how we are going to grow it and I think those proceeds came from a disposable large number of pubs two years ago. Our view was that disposal wasn't to shrink the business, those proceeds will be reinvested in growing the business. So our ambition, our belief is we will spend that in time on growing the business in the areas that Alistair talked about.

Question 7

Richard Taylor, Barclays

Morning, Richard Taylor from Barclays. Partly as a follow-up to the question there. On the cash pile versus the capex ambitions. £50-80 million of capex, depending on what you decide to do on dividends and given the pension versus the cash pile and the desire to grow the business. I would assume you could probably grow from, you could use existing cashflow for the capex proceeds rather than using the cash pile. Are you saying there are other brands or concepts you would wish to add to grow the business or would you be doing it organically?

Alistair Darby, Chief Executive:

Our view at the moment is that there is an enormous amount of opportunity in our existing brand portfolio and it makes sense to concentrate our efforts on those. Over time and as we monitor the market we will see whether opportunities, there are opportunities that open up. But at the moment having done the consumer research we have done and seeing the scale of our brands at the moment, there is a lot to go at with what we have got. So that is where we would really like to spend the cash, is growing the strong brands that we have got organically over time.

Alistair Darby, Chief Executive:

Any more for any more? If not, thank you very much for coming along, have a very good Whitsun break if you are taking a break that is. Thank you.