Mitchells & Butlers 2014 Final Results Announcement
Tuesday 25 November 2014

Q&A Session

Question 1
Male
Good morning. On page 22 delivering the growth plan. You can see the growth planning, you can see the split between the expansion and the optimisation. If you are growing and targeting 70% in 2016 as in the revenue mix, what is that going to look like in terms of profit? Does that mean the margin is going to be a lot better in the expansion?

Answer :
Yeah, essentially the question if I am correct is what is the profit profile difference between brands that sit in those attractive market segments versus Heartland. I think the point to make is first of all, there are some tenure differences so you have obviously got a much greater leasehold mix when you are developing in those attractive markets because All Bar One, Miller & Carter, Harvester also will have a leasehold bias, whereas Heartland has the advantage of being a freehold business so that helps in terms of some of the operating margin.

Fundamentally though, we always say that when you net off gross margin against the cost of operation, all of our brands on the whole create the same kind of margin. So it is not a real difference between those brands. So we would expect brands in whatever segment, when it comes to conversion after adjusting for tenure and food mix to be pretty similar. And that is why we are interested in developing the entire business because they have all got, when it comes to generating profit, attractive dynamics.

Further answer
But cash margins more important than percentage. I would not want to forego cash margin just because I want to protect a percentage margin. And if there is a driver of percentage margin that is around the drink food mix rather than around the premium value mix. So drink led Heartland businesses deliver fairly high operational margin.

Question 2
Victoria Greer
Can you talk us through where like-for-like growth is coming from?

Answer:
I would answer that question in two ways. First of all the volume recovery in our business has been pretty broad based. But you would say the biggest driver has been those brands where value is important. And I think that is kind of in a sense self

evident I guess because as pointing out in those consumer trends. That demand for value is so strong that if you don't get your price point right then you are going to get hurt by consumers. Equally if you do get it right, I think we have made a huge amount of progress in the last year, then those guests will come back because they are incredibly aware and sensitive to price. I think one of the things that is really striking from whenever we do consumer groups with people who use Miller & Carter or people who use our Heartland pubs, when it comes to people who really know the cost of everything and budget most accurately, it is absolutely consumers in our Heartland estate. You ask somebody who is using Miller & Carter what the price of a pint of milk is, they might not know. Ask somebody in the Heartland, they will tell you what the price of a pint of milk is in four supermarkets. In fact we had a consumer group recently where one guest was able to tell us what the price of fish and chips was in 8 competing brands. So where we have been investing back in value you can see a particular effect in those more value led brands, but it is broad based.

Further question
Benefits from acquiring Orchid? Still at the £6m level?

Answer: Tim
Yes and yes. So we have quoted 6, I think we said at least 6 in the RNS. We are still very comfortable with that and think that if anything we can slightly over deliver on that. The benefit from purchasing of course is one of the key drivers of Orchid, that feeds through in the unconverted sites just by lowering the costs they are selling and feeds through into the converted price sites as well as they come onto a sort of standard Harvester or Toby template.

Further question
Please can you talk through the amortisation by year for the next 3 years?

Answer: Tim
Yeah, so FY, so the current year amortisation is 61, in FY16 it is 67, in FY17 it is 77.

<u>Question 3</u>
James Wheatcroft, Citi
Morning, James Wheatcroft from Citi. Two questions please. Firstly can you talk about, you talked about volume, but can you talk about what you think is going to happen with price? Are you going to make a change at some point and when do you think that might be?

And secondly, you talked about a net debt to EBITDA target, can you give us some colour on that please?

Answer :
Okay, let me take price. I think the important thing to recognise is that we are not going to be a business that does not take price increases, I want to reassure on that. What we are not going to be though is a business that takes price well ahead of inflation and well ahead particularly of wage inflation. And I think the simple harsh truth is we were a business in FY13/FY12 who moved prices significantly ahead of wage inflation and in fact wage inflation was static/declining. And you can see really in the results in FY13 the effect of that, because in FY13 we moved prices by about 4-5% but our volumes declined by 4-5% and we had like-for-like sales of 0.4%. We have come to a point where essentially price increase was like pushing on a piece of string, it was having no effect at all. So having addressed value, our approach to price will be what I describe as gentle. So we are going to keep a very close eye on

what is going on with consumers, how much cash they have got in their pocket and we will recognise very clearly that first of all, we should not overstretch pricing ahead of what consumers are doing. Secondly, we should also be acutely aware that if you are going to put your prices up then there needs to be stuff going on that deserves that price increase. So an investment in the pub, better service, fundamental improvement in the brand are all important. I think the days where you can just automatically whack up your prices by 2-3% per year and everybody just sucks it up have at this time gone. So I think we are going to be very sensitive, very calculated, but we will seek to put some gentle price increases through in the business because after all we do have a rising cost base. So that is going to play a part, but just more carefully than in the past.

Further answer: Tim
In terms of net debt to EBITDA, we don't have a specific point target externally nor internally. I think, for the past few years we have been saying we would like to see our gearing drift down and that is why we have been looking to fund bond amortisation out of current year cash flow. But where we are is affordable and does not need to come before all else. As witnessed by this year, we felt comfortable buying Orchid, that has taken net debt EBITDA from 2 to 4.5, that is fine. We would like to now see it drift down a little bit from 4.5, but not before all else. We can afford the level of gearing we have. We would just like it to be slightly lower.

Question 4
Jamie Rollo, Morgan Stanley
Jamie Rollo from Morgan Stanley. Three questions please. First could you give us the like-for-likes were in the Heartland estate last year?

Secondly, there is a small benefit from a lower depreciation charge which looks like it must be really right down, given capex went up. Would we expect the D&A charge to start moving up with capex?

And finally could you give us a feeling for capex in 2016 because I think it is unusually high on maintenance because of EPOS and would that come back by about £20m or so? Thank you.

Answer :
Orchid's like-for-likes, we are not looking to start breaking our like-for-likes out segmentally. I think we have been clear on the qualities of basis that Heartland has been in volume decline recently and that is a lot of what has driven back the improvement now. So I think it gets me back to, I am a bit loath to put a number on it. In terms of Orchid, since I have just asked myself the question, Orchid continues to perform very well and Orchid has just for clarification, Orchid is not in our like-for-likes okay, and it won't be until we have owned it for a year. But if you just ring fence it to the end of this financial year, Orchid's sales grew at a slightly higher level than the rest of M&B. Since the year end, the last 8 weeks actually our 2.4% number is a faster level of growth than Orchid has achieved. So it has not kept up with our recovery if you like.

I think the depreciation charge is about £1 million lower this year than the previous year. We spent less capex the year before so a lot of it is a flow through from that. As we are spending more on till systems and opening new sites you should expect that to begin to pick up which I think is what you anticipate to your question.

And the last question, was it FY16 capex, so in FY16 in terms of maintenance capex, I expect we will be keeping the level of remodels about the same. So that should not move. We will have completed our till project and we will have completed the finance system and HR area, so we will have completed all of our IT capex investments. So I think you will see a small shift down, maybe sort of £4-5 million, something like that and then index from that. In terms of expansionary capex, I mentioned £65 million on my slide as guidance for next year, I think probably a similar level in FY16, so you will have another £18m coming from Orchid, the core M&B will be the same or slightly higher depending on what we can manage or what we can find.

Question 5

Jeffrey Harwood, Oriel Securities

Jeffrey Harwood from Oriel. I have got two questions. First of all looking at the 70 or so Orchid pubs that are not going to be converted, what are the plans for those? Could some of them be sold?

And secondly can you give us some feeling on the level of bookings for the Christmas period?

Answer

So what we are going to do with the part of the Orchid estate we are not converting immediately is put it into our Heartland estate. Some very good reasons for that. Quite a large number of those pubs in that run for Orchid have been recently invested in. So Orchid stepped up their investment programme into Pizza Kitchen and Bar and All Inns and also carveries as well in the run up to selling the business. So there are a number of pubs in there that are in good nick where investment of capital at the moment would not make sense. So we would expect to be able to get at those pubs in 2 or 3 years time and review them for conversion for core brands. What that will then leave is and we will also invest in some of those pubs as Heartland pubs because they have not received any investment in Orchid.

In terms of plans to dispose of any assets, that is not a feature of our plan for Orchid, these are good freehold assets that we think we can make more of through our scale and through our conversion and so on.

In terms of your second question which is about Christmas, the good news at the moment about Christmas is pleasing, but I would like to caveat that and let me explain why. At the moment our bookings for Christmas and total Christmas so that is a combination of Christmas and the big day, Christmas Day are running in total just north of 5%. Christmas Day particularly is very strong, bookings for Christmas day are up by about 10% so far. However that is compared with exactly the same point last year. It is still the case that actually the vast majority of Christmas bookings come in this week and the next week, that is because people leave this very, very late. So we are very pleased with where they are at the moment, Christmas is looking good, but there is a big chunk of bookings still to come in the next two weeks. So I think we will keep an eye on those, but so far so good.

My view is there are two things going on here. I think the fundamental point that when it comes to big occasions, Christmas, Mother’s Day, then nobody wants to be embarrassed and they are going to put on a big show at home or increasingly because how many people cook big meals at home now, they want to go out and be looked after. And very high expectation. When you are eating at one of our premium pubs on Christmas Day before buying any drinks, you are looking at 50-60 quid a head, so this is a big thing. But people don’t want to be embarrassed, they want to have a great time with families and friends.

I think the other thing is whilst, again we should be cautious, I think the drop in cost inflation so petrol pricing having dropped off, food price deflation in supermarkets, has had the effect of making consumers just feel a bit more cheerful. Now long may that continue so some evidence from the Asda income tracker that the average family is about 8 quid a week better off than this time last year. That is helpful. At the margin it will make people feel a bit more cheerful. So I think that is also playing a part. But I think we should just be careful because what we have seen, particularly through the course of this year is how quickly consumers can be buffeted by unexpected news. And I think that is a product of people having learnt harsh lessons from the early noughties when they ran up a lot of debt and people are still. They are going to go out and have a good time but they are always going to be mindful of the state of their household finances. So I think we have just got to keep an eye on that. But at the moment we are quite encouraged by what we are seeing.

Question 6
Tim Barrett, Nomura
Good morning, Tim Barrett from Nomura. Can I ask you that question about the core M&B estate. Are you looking at disposals in 2015 and are you still reviewing or do you review golden brick opportunities as they come up?

And then a question on Orchid. From what you have disclosed for the fourth quarter, it looks like it is nearly a 15% operating margin, which is some way ahead of the full year. Is that business more seasonal than M&B?

Answer
I will let Tim take the one on Orchid, but as far as gold bricks. Fundamentally we like owning freehold pub property. And one of the reasons we like owning it is because the experience is that its value accrues over time. So we like running pubs, we like owning the freehold. Equally we have a view that what may look like really hot prices in London and everyone is calling top of the market. Our view is once you have sold an asset, you have gone, you have missed the opportunity. And fundamentally we are in the business of running the pubs that we have got and we have the advantage of being in the position where from a debt position, we are not overstretched, so I think we are right to hold onto wherever we can the freehold ownership of properties and keep an eye on what may come next. No end of people have called the top of the market in London for the last 200 years and not yet got it right. So what might look like gold bricks today is probably going to look even bigger gold bricks tomorrow.

Further answer: Tim
In terms of Orchid margin, in its 15 weeks it made £41m of sales. So it is a good margin, slightly lower than M&B, but it is a good margin. We managed to get some purchasing efficiencies, but minimal in the context of those numbers and the way they come out. I think the important thing going forward is that margin will decrease in the next two years because as we go through the conversion programme we will be taking on £6 million of opening costs in each of the next two years. So you should expect Orchid's margin to come down substantially for the next two years, it will then emerge as part of the M&B estate with a higher margin when it is fully converted.

Question 7
Paul Rivlin, Palatium Investment Management
When bond holders in securitisation, when the bonds were sold to us, they were sold on the basis [01:07:02, not possible to hear question clearly] and accordingly we would expect you to be indicating your plans for either redeeming the bonds or at least offering the bonds a get out. I haven't heard that today, all I have heard is that

you are planning to let the bonds run on through to legal maturity and that would be very disappointing.

Answer
Okay we took step ups on four of our bonds last September, 14 months ago. At that time we reviewed what was the right thing for us to do, whether we should retire or not, It was clear that the debt market conditions then and now that was not in our interests to do it. The step up in my understanding, gives us the option to redeem those bonds at par, it does not give us the obligation to redeem those bonds. I obviously wasn't here when those bonds were issued whether there was an implied promise, but certainly there is nothing I have seen nor an explicit promise. So I guess my position is we will keep it under review. But we are not looking to refinance those notes until it is in our interest to refinance them.

Further question
[01:08:21, Not possible to hear]

Answer
I can assure you we are thinking hard and it is under review. I cannot say that we would do it if it was not in our interest to do it. I would be delighted to meet with you and have a discussion about it, but my understanding is we have an option to redeem, we do not have an obligation.

Closing remarks

Any more for any more or shall we let you get back to your desks? If not, thank you very much indeed for coming along and if we don't see you before, have a very good Christmas as I hope we will.

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