Mitchells & Butlers

Mitchells & Butlers Half-Year Results 2011
Friday 20 May 2011

Q&A Session

Question 1
Kate Pettem, UBS
I wonder if you could spend a little time on margins. You make it sound like you have made no progress at all from the scale benefits you outlined at the strategy day now a while ago, and I suspect that is incorrect. I wonder if you might be able to break out some of the margin movement due to scale and procurement benefits and what you would expect for the second half?

And I am wondering as well if you were confident that you will offset all of the cost pressures from food and other items in the second half?

Answer – Tim Jones
Well referring you to my slide Kate. There have been some procurement benefits in the period and they have gone some way to mitigating against the inflationary increases in the first half. If you sort of normalise or add back Easter and the effect of expansionary rollout then margins are effectively flat so I guess what that tells us is that the sort of benefit of leverage is balanced by the effects which we couldn't mitigate on inflationary cost increases in the period.

As we look forward we would expect a stronger margin in the second half,that seasonal part of it and that is also partly due to a number of initiatives we've got in place. And as we look to next year, I think we have got quite a strong headwind coming on on energy. Jeremy talked about that. We estimate the impact of that to be about £10 million. That has a lagged effect on us because we buy staggered forward energy so the current price now hasn't sort of fed through to what we are paying today. So it is really next year's impact. So we have got to tackle that.

And I think you know in our guidance we would look for slightly stronger margin next year than this year by a few ticks. So we would look for sort of leverage benefits and our internal productivity measures to just get ahead of those headwinds.

Question 2
Nicholas Thomas, Nomura
Good morning, it's Nick Thomas from Nomura. A couple of questions. Firstly you talked in the segment about your expectation that the brand rollout of capital investment will accelerate into next year. I wonder if you could talk a bit more about

the visibility of the pipeline being put in place to back that up in terms of quantification? And any kind of view on the mix of that pipeline in terms of leasehold, freehold and more sort of traditional pub restaurants compared with retail and leisure parks?

Answer – Jeremy Blood
We will open 50 this year and we probably think we will open about 75 acquisitions next year. In terms of the total visibility on the pipeline, we have named numbers for each of those 75, but as a pipeline with 18 months out you will find some will come in and some will go out. But we are very confident that it is a good robust pipeline that will deliver.

In terms of the balance of freehold and leasehold, I think by numbers of units, leaseholds will be the larger number, particularly as we take advantage of moving brands like Harvester into these new locations. In terms of capital spend and capital investment, freeholds are obviously more expensive than individual leaseholds. It is hard to predict exactly where it is going to be because the pipeline is still moving, but we will see that to be closer to a balance. So 50-50 in spend terms, probably still slightly more on leaseholds. But it is a moving target at the moment. But our aspiration is to get a balanced mix of freehold and leasehold opportunities as we go forward in terms of spend, but we don't want to miss out on these new locations. So that is the approach I think.

Further answer – Tim Jones
The only thing I would add is there will be a residue of conversions as well on top of that. So 50 conversions this year could be 15-20 next year. So declining to a fairly low stable level.

Further answer – Simon Burke
It is worth adding perhaps just that we don't see in strategic terms the need to radically alter the mix of freehold and leasehold in the Group as a whole. So clearly this activity will entail some dilution of the freehold mix, but we don't see that as being radical even over the medium term.

Question 3
Geof Collyer, Deutsche Bank
Geof Collyer from Deutsche. Two questions. Firstly, if you announce you are focusing on remunerating staff on the improving return on capital, is there a danger that some of the businesses start to under invest which you then underperform?

Secondly, if you look at the check list you gave in terms of where the cashflow has got to go, sort of £280 million of annual outflow, is the dividend consideration presumably going to be after you have taken the amortisation costs in addition to that £280 million to further reduce the potential for payment of dividends and maybe the level that you used to pay them at?

Answer – Tim Jones
In terms of the dividend, as I say, we have got to look at the cashflow that the estate generates, less the commitments we have against that. Now you know, the pension is pretty fixed for ten years. Our interest bill is pretty fixed, so it is not going to change majorly. So they are sort of givens. As we invest in expansionary capex of course, we are continually growing the cashflow that the estate can generate because the

estate becomes larger. So as long as the expansionary capex doesn't seriously accelerate into the future, then pretty soon that balance should change and really so the decision comes on, how strong is that pipeline of expansionary capex we can see? And for how long can we see 20% returns you know at the end of our nose, that we continue to invest in? Whilst we can, we will continue to do that, but that shouldn't ultimately prevent the cashflow growing because last year it was always growing the estate. The only thing I would add to that is, it is not primarily a formulaic or numerical decision. You know, we also have to overlay on this our outlook and our view on consumer spend going forward at any given time when we make a decision.

Further answer – Jeremy Blood
On the incentives, will incentivising the people on return on capital and applying capital charge cause them to under invest in the assets? I think incentives always have sort of always direct people towards one set of behaviours rather than another, that is what they are for. I think actually it is the right time in M&B to really drive capital efficiency in that regard. I don't see it as a risk, we are very committed to long-term investment in the quality of the assets and long-term like-for-like growth. So I don't think at the moment that just a sharper focus on capex is going to cause us to under invest in the assets.

Question 4
Tim Barrett, JP Morgan Cazenove
Tim Barrett, JP Morgan Cazenove. On conversions, just checking a point there. You talked in the past I think when you sold Stonegate of about 160 sites for conversion and yet you suggest rather fewer of those are being done. Can you update us on that?

And then the second question relating to the cash outside the securitisation and more generally your attitude to leverage outside the securitisation, could you give us your thoughts on that?

Answer – Tim Jones
Well in terms of conversions, I think we did just over 50 last year and we are saying we will do about 50 this year. And I have now just said more like 15 or so for next year. So that is a little shy of 160. I think all that reflects is those are the ones that we can see now in this climate will give us a decent return going forward. No one has said we are never going to do a conversion after that. I think it will be kept under review and things will get mopped up as conditions change, as trends change, as consumer preferences change. So we are not saying they won't be done, but as of the moment, no we are not pushing forward to do 160 by the end of next year.

In terms of the cash outside of the securitisation, what are our plans for it, was that the question? Well I think that cash is included in the net debt that brings us below five times net debt to EBITDA. So I think it is important in keeping us at what we consider to be an appropriate balance sheet. The great value of having it outside of the securitisation is, firstly it has allowed us to repay the structural inefficiency we had, but we had cash balances in the securitisation and drawings outside the securitisation. So by taking out £460 million, we have paid down over £250 million of debt. That alone generates a lot of value for us in terms of a lack of inefficiency. I think also having it outside of the securitisation gives us greater flexibility on what we want to spend it on and where we want to spend it. And it gives us access to a pool of funds to accelerate any new site openings or even M&A should that come along in the interim so that is why we need it outside of the securitisation. What I don't feel, if

this is behind your question, is that it is burning a hole in our pocket because it is part of our whole balance sheet. It is not a pile of cash we feel under any pressure, certainly not in the short or medium term to distribute because we feel that we will have a use for it.

And the dividend decision, coming back to my earlier answer, is made primarily on the operating cashflow within each year of the business. We are not going to get lulled into paying a dividend out of our balance sheet and then having to do that. That is not the right way for us to manage this Group.

Further question – Tim Barrett
Can I just come back on conversions, you used to say they were the highest return category, is that still the case or has it become more marginal?

Further answer – Tim Jones
Actually, taken as a two populations, the acquisition capex is slightly higher return around that 19% than the conversion capex in this period. So I guess, no, factually that is not correct for where we are today.

Further answer – Simon Burke
It is worth remembering in relation to conversions, it is a binary equation so it is not only about potential income that can be got from the new format, but it is also about the performance of the existing, the pub in its existing format. And actually there are quite a few cases in the portfolio, where improvements in performance of the outlet under its existing branding or positioning, whatever that might be, are such that we are actually content to leave it as it is and to trade with that, because the marginal return we get from the investment is reduced. So it is not pulling back from something, in some cases it is actually a positive story about how they are doing as they stand.

Question 5
Jamie Rollo, Morgan Stanley
Thanks. Jamie Rollo from Morgan Stanley. Three questions please. I think you said that Harvester that is running still in double digit like-for-likes which looks like it explains about half the Group's like-for-likes in H1, clearly very good result. Are there any brands that are negative that you think could benefit from a similar sort of turnaround that Harvester has seen?

Secondly, the £34 million of disposable proceeds in H1 ex-Stonegate, is that something over and above the disposals announced last year that completed late or is that something else? And should we expect any more proceeds in H2 or indeed next year?

And then thirdly, are you still committed to the old margin targets of 300 basis points of margin growth over I think base 2009? Thanks.

Simon Burke
Jeremy do you want to start by talking about the brands?

Answer – Jeremy Blood
Harvester. It is always a danger that you shout about how well Harvester is doing, then people will say, well that means something else isn't doing as well. And you know in a portfolio it is an average. So you are obviously correct, but in actual fact all

the brands are in positive like-for-like territory. The brands which are doing less well, I won't name and shame them, but the brands doing less well are the ones which are where there are is perhaps more work to be done on the brands, but particularly those where we have got to do more work in driving them towards food and food growth. We have got plans under way on that one and intensive brand work on them. But you can probably work out which ones they are going to be, but I am not going to name and shame them.

On disposals, do you want to talk about disposals?

Further answer – Tim Jones
The non large transaction disposals Jamie I think, you know that sort of packages or individual assets that were sold in this period. You shouldn't see that as a continuing activity or cash stream. I mean there may, going forward, be as in any estate management, one or two assets that come in or out there, but there is no ongoing disposal programme any more on those assets.

And lastly on the margin, margin has come off a bit this period. We talked about the reasons behind that. I don't think they are structural, I think they are market related. And we are not distancing ourselves from the margin target that the Group came out with a year ago.

Further answer – Jeremy Blood
The work on brand improvement, menu improvement, food margin, those are the underlying structural improvements that will drive margin and they are intact.

Further answer – Simon Burke
I can reassure you that the Board is not letting up on that one.

Question 6
James Wheatcroft, RBS
James Wheatcroft from RBS. Another question on returns please. This time last year you were talking about returns on expansionary capex of between 20-30%. And today you are talking about 19%. I wonder whether you could give us some colour behind that number in terms of whether it is maturity profile mix of sites which reduce those returns basically?

Answer – Tim Jones
Yes, I think that you know the 30% was probably in hindsight not ever a sustainable number. And as you start on any programme of these conversions, the ones that are quite rightly done first were those that gave the quickest and the most lucrative return on capital, particularly the number of value brands that were rebadged quite cheaply with very powerful impacts. I think the effect of that is then exacerbated by the fact that we were doing less at that time, so the average moves around a lot more.

And I think probably the third point is, when we do a re-branding or a conversion, we typically see the return sort of grow generally over a couple of years. So to the extent that we have accelerated this programme, the average age if you like of your investment is younger, so you would expect it to be less mature in that growth profile. All of which would lead to a fall in that return.

Further question - James Wheatcroft

So what could we expect to get from the sort of 19% to rise to?

Answer – Tim Jones
Certainly you shouldn't be pencilling in 30% into your numbers. I think around 20% is about right, that is entirely consistent with our hurdle rates that we published last year and we will continue to make sure that we improve investments that can make those hurdle rates.

Question 7
John Beaumont, Matrix
Thank you, John Beaumont from Matrix. Just wanted to go back to the guidance given on input cost increases both on food and energy for FY12. Can we take it that although we are likely to see some food input costs, it sounded like you were going to be able to mitigate pretty well all of that through productivity improvements etc and volume growth in your main brands. But on the energy side, the £10 million of extra costs there, I just wondered, is that based on current pricing of energy you are seeing in the market at the moment or is that what you have already locked in? I am just trying to gauge when you actually lock into whatever new contracts you are looking at and so therefore if energy prices come off a bit, is £10 million going to be a bit high?

Answer – Tim Jones
That number sort of assumes the old price stays where it is. I mean it has come off a bit I know recently, but it is still round about $100 a barrel when I last looked anyway. Were it to come down significantly in the short term we would benefit from that and that £10 million number would come down. We start buying about six months out a proportion of our expected demand, about a quarter six months out. Buy more a quarter out and then buy on a monthly basis when we get within the period. So we have a sort of lagged or dampened impact if you like. And if the oil price collapses tomorrow that would be great.

Comment – Jeremy Blood
It might mean that something bad happened!

Comment – Simon Burke
Or people go out and drown their sorrows in that case!

Question 8
Jeffrey Harwood, Oriel Securities
Jeffrey Harwood from Oriel. Just two questions. First of all on the dividend. Has there been a slight change of emphasis here? I think last time there was a statement along the lines that board was committed to resuming a dividend payment.

And secondly holding these significant cash balances on the balance sheet for any period of time is clearly pretty inefficient, is there an opportunity perhaps to cancel some of the debt?

Answer – Simon Burke
There are two parts to that question. I will talk about the philosophy and then ask Tim perhaps to talk about some of the particular aspects of it. There isn't a change in

our position. I mean I think if I am being absolutely honest I think one or two slightly off the cuff remarks last year ended up being rather over interpreted and we found ourselves on the receiving end of a sense that we had committed to a dividend almost by a date and that was never what we intended. And the fact, the reason we have sort of repeated the statement if you like at this point is that we don't feel in a position to make a decision right now. It isn't that we have made a decision in the background and are not telling you, it is that we haven't yet and we are genuinely going to keep these things under review. We absolutely understand the desirability of a dividend in the wider marketplace. We have taken account of our shareholders' view on the subject and we will balance all of those factors along with what we said earlier in the presentation to come to a view about it. So we don't mean to change the position, but I suppose as I say, we allowed it to become a bit overstated last year. So we are trying to set the record straight in that regard.

As to the financial specifics, Tim do you want to?

Further answer – Tim Jones
Yeah we have worked, as I mentioned earlier Jeffrey, to maximise the efficiency or minimise the inefficiency of that cash by offsetting it against unsecured debt. I do think you need to look at that cash in the context of the balance sheet as a whole rather than as one account within a plethora of accounts. And we have £2 billion of debt, so whilst a number of people tell me we are net cash, actually we are not, we have £2 billion of debt. But it is there and it is available and we can use it. And we do challenge ourselves hard on what the uses of that will be. In the near term we think there is a strong pipeline of investments that I've talked about, have looked at whether one would want to buyback debt. It doesn't seem to give us the returns that we can get elsewhere. I don't see a return of capital to shareholders in the near term as something being attractive, I don't see any point really in doing that if we are not doing a dividend stream And if we did do that we would, it would be a Type A event, so we could, a proportion of it would go into the pension fund anyway. So I think for the moment it provides us flexibility and security to make our investments and to move quickly to generate value and that is a position we are very happy to be in.

End of Q&A