Mitchells & Butlers H1 2019 Analysts' Presentation

Thursday, 23 May 2019

Tim Jones, CFO So, good morning. Thank you very much for joining us today. I'd like to take you through the financial elements of our performance in the first half. I'm going to hand over to Phil who will look at a lot of the operations and strategic progress that we've made.

But maybe before I start here are the key messages that we would give you to take away from the set of results. We're really pleased. A very strong trading for us in the first half. We have good like-for-like sales growth and acceleration in that over previous years, and that remains well ahead in the market.

What we're starting to see is the whole plethora of initiatives that you'll hear a lot about today that we've been instigating over the last two years really started to get some traction and have an impact within our P&L, and that's allowed us to deliver operating profit growth and that at an increase percentage margin as well.

Looking slightly further forward the market will remain tough, and, in particular, I'll talk a bit about our cost headwinds, but we expect them to persist over the next few years, and our priority in that environment will be to continue to get traction with our initiatives, to maintain investment in our estate, and to de-lever our balance sheet.

So, let me start with the P&L. Total sales grew by 5%; that geared well to over a 7% increase in operating profit. We're starting to see the benefit of reducing our net debt, and I'll talk a little bit more about that. That's coming through in a reduced interest charge, so we had nearly an 18% growth in PBT over the first half at a 20 basis points increase in our operating profit margin.

I'll now go through layer by layer of the P&L. So, starting as always with sales, the first half like-for-like sales were up 4.1%. It slightly came off a little bit in the last five weeks, up 3.8% in the first 33 weeks, so that's up to last weekend.

Now that's an acceleration on last year's and the year before's sales growth, really on the back of an increase in spend per head, so we're getting the benefits of the premiumisation mix across the whole of the estate, and there's a little bit of like-for-like price increase in there as well.

What we have seen though in this half is a marked improvement in our volume trajectory. Both food and drink were almost flat, under 1% down in the first half, compared to much steeper declines through last year. So that's had a very powerful impact on our sales as well.

We're seeing a pretty balanced growth across the estate. Last year was very, very drink heavy. If you look at this first half, much greater parity between our food sales and our drink sales, and also quite an emphasis on special occasions within that.

Now, before moving on down the P&L, I'd just like to spend a bit of time pulling out a couple of features of our sales performance. We won't do this every time we present, but it'll give you a slightly deeper insight into where the sales growth is coming from and how it's playing out through our estate.

If I start on this chart, I've set out a few. The like-for-like sales growth, it's smoothed into a moving average, on the left-hand side. On the right-hand side, that is our like-for-like sales growth on the uninvested estate, so that's all the sites that have not had the benefit of capital in the period.

What you can see from comparing those two charts is that, of course, capital remained very important to what we're doing with the estate, and we'll talk a lot more about that. But crucially for us, we are seeing a great response from our uninvested estate as well.

So, what that tells us is that aside from capital, the whole plethora of other initiatives that don't require us to write cheques to spend money on sites are also having a tangible impact in uplifting the overall sales and performance across the Group; with uninvested like-for-like sales up 2.1% in the first half.

Secondly, as you'll be aware, we've got about 14 different brands or formats. Across a portfolio like that what you'd normally expect is quite a wide range of performance in any given period in certain brands at different stages in their development and their cycles. We had a very encouraging raising of the whole bar, if you like, across the whole of our estate. So, in the year-to-date, all of our brands are like-for-like sales growth positive.

If you look at this chart I've just split them up into the three cohorts that the Coffer Peach tracker looked at, and as you can see, all outperformed the market in their respective areas, particularly Restaurants, driven largely by Miller & Carter and against a very flat comparator from the rest of the market. So that's sales.

Costs absolutely remain a challenge for us. We guided you at the beginning of the year that we would expect inflationary cost headwinds of about £65 million this year, so that's before anything we elect to invest in; that's purely inflation. That guidance pretty well holds. We managed to mitigate about £13 million of that in the first half, as you'll see later.

Probably the particularly acute one for us this year has been the utilities, which has shown a sharp increase year-on-year. If we look forward to next year, we expect the inflation to be of the same order, probably slightly less, maybe £60-£65 million, rather than the £65 million this year, and I would hope that utilities aren't moving apace at quite the same rate that we've had to deal with this year. So, that will remain tough and that will remain an ongoing challenge for us and all businesses in our sector as we go forward.

If I put all those together to what's happened to our P&L, you'll be aware last year we suffered from the snow, Beast from the East, a lot of cold weather, so not having that clearly helps. Against that, we lost Easter out of the first half this year, so there's a net £5 million benefit to us from those two.

If we then play through the returns we're getting on our capital programme, investments made last year coming through, the costs of investments we made this year, the inflation cost headwinds, the £13 million we managed to offset, that leads to an overall performance of operating profit up £10 million in the first half at £151 million. So, a very strong increase in operating profit.

As I said before, capital is important to that; it's one of the three pillars of our strategy around building a balanced business. Total capex spend in the first half was slightly lower than it had been in the first half of last year. You probably shouldn't read too much into that; it's essentially timing.

We gave guidance at the beginning of the year that we would expect to spend £175-£180 million capex this year. That guidance still holds, so you'll just find slightly more of that probably come through in the second half. Most importantly, our returns that we're getting on invested capital remain good and, indeed, are strengthening further from where they have been. Remodels being done in the current year are up at around about a 35% EBITDA return for us.

Cash, of course, pays for a lot of that, and our cash flow's been very good in the first half. We generated 66 million of net cash flow which, after bond amortisation of £43 million, allowed us to reduce net debt by just over £20 million. That takes our net debt down now to £1.6 billion. So we're below 4x; we're at 3.8x. Great progress we're beginning to see on deleveraging our balance sheet.

It's probably worth at that point just pointing out or reminding a lot of you about our balance sheet strategy, our capital allocation strategy.

We are a business with mandatory fixed charges on our cash flow, notably our debt service, which is £200 million, and notably, contributions that we're making to the pension fund approaching £50 million a year. Our first priority, of course, is to meet those obligations and then continue to invest in our estate to remain competitive. We believe we can do that.

This chart essentially stylises what that we would look like if you assume flat profits or a flat enterprise value. You see over the next ten years we get a growing richness of the equity value within M&B as we pay down our debt and we hopefully manage to solve, if you like, our pension deficit. So, we're on that journey and we're confident of creating significant value through that journey.

Before I hand over to Phil, maybe just reiterating on those main points, very strong trading in the first half, good like-for-like sales growth that remains ahead of the market, getting some real traction coming through from all the initiatives that we've start into our P&L, and that's allowed us to grow organic profit at an increased profit margin.

Looking forward, cost headwinds will remain tough but no tougher than we've been dealing with this year and last year, and our priority will be to meet those and to continue to deleverage our balance sheet whilst keeping M&B with the best estate in the industry and well-invested. Thank you.

Phil Urban, CEO Thanks, Tim, and good morning, ladies and gentlemen. Tim has just taken you through the first half numbers. It's fair to say we're very pleased with the progress we're seeing in the first half, seeing a £10 million increase in operating profit is a big move forward for us as a business.

It's the second consecutive half of profit growth, and as Tim says, comping against the Beat from the East certainly helped half-one, but Easter shifting worked the other way, and I think along with some other one-off costs we've had to absorb in the first half we're confident in saying that first-half profit growth is a definite underlying £10 million-plus region. So, we're pleased about the first half.

Our sales performance has undoubtedly been the driver of that momentum. We've had a very good Christmas, as we previously updated you on. I think at the end of February we had unseasonably warm weather and had a strong trading period there.

We also had an exceptionally good Mothering Sunday weekend, with Mothering Sunday itself being our third highest-ever taking day, only beaten by the previous two Christmas Days, so I think that just more evidence that we are beginning to have an estate that really appeals on those special occasions. Also, it talks to the booking processes and systems that we've now put in place.

Pleasingly, as Tim said, we've remained comfortably ahead of the market in terms of like-for-like sales, as measured by the Peach tracker.

I should say we measure against the total Peach tracker, so that's all the pubs, pub/restaurants, and restaurant contributors as opposed to any self-defined cohort; it's the total Peach tracker we talk about. By my reckoning, we've now had 11 straight quarters of outperformance, almost three years, in truth.

Our like-for-like sales were at 4.1%, as Tim said, in the first half; uninvested by 2%, which is evidence it's not just the capital that is driving our recovery, if you like. I think it's the Ignite transformation programme – which I'll talk about in a few more moments – where we have a lot of initiatives trying to drive incremental sales that is being reflected in that part of the business.

Half-two has started a little slower, but I think a combination of Mothering Sunday, Easter, and Bank Holiday being so close together – which always puts a stretch on the household spends – and year-on-year unfavourable weather and sporting occasions means that we see this as a blip. Pleasingly, when we've had the odd day where the weather factor disappears, then the like-for-likes come back. So, we see it just as a vagary of the time of year as well at the moment.

What I'd like to do this morning is update you on our current read of the macro-environment and the sector, focus in a little bit more depth around our sales and what have been the drivers behind those sales, then close with our cost efficiencies and the programme we have to try and drive efficiencies through the business, before finally looking at the things we've got in the hopper which we think drives further growth down the line.

So, starting with the macro picture. Now, as we've stated in previous updates, I think the ongoing uncertainty over Brexit and the political instability that has caused is far from helpful. Businesses need to have certainty or at least confidence in that macro landscape for planning, otherwise, it becomes very difficult to plan.

We've taken a pragmatic view that it's outside of our control, so we are pressing on, on a business as usual basis, and we'll accept the fact that we might have to reappraise down the line if the macro landscape suddenly changes.

Our sector is reflecting that macro instability on our ongoing cost burden, a more competitive CVA, and administrations even this week, as we've seen, being announced, and overall restaurant supply dropped by 2.8% in March just gone. So, clearly, a reduction in the number of competitors is helpful to us and we don't expect that trend to abate any time soon, particularly in the leasehold space.

There's also real evidence, I think, that the consumer is increasingly looking for experience, so real, high-quality food and beverage, for sure, but also in terms of the service and environment in which they're getting that food and beverage.

Now, these have always been pre-requisites of any good hospitality business, but I don't think it's ever been more pronounced than it is at the moment. And with the growth of home delivery, I think bricks and mortar operators like ourselves have to ensure that the out-of-home experience is special and good enough to drag people away from home. So, it's something we all have to really work hard on. We expect to see more competitor investment in strong brands and offers that are solely reliant on discounting to continue to struggle.

The momentum we're seeing I do believe is because of the structured approach we've taken to try to turn around the business. Our three strategic priorities haven't changed and won't change, the first of which is building a more balanced portfolio, which is all about raising the quality of our amenity right across the portfolio, getting onto a six- or seven-year cycle of reinvestment, accelerating and expanding our most successful formats, and ensuring that each of our brand propositions is kept fresh and relevant and grounded in deep customer insight.

Secondly, instilling a more commercial edge to the way we do business, which is simply about putting the customer at the heart of all that we do and ensuring we're clear on how each pound of sales is converting down for bottom-line profit.

And finally, driving an innovation agenda which, for us, is about making the technology that we've put into the business work for us, making digital marketing an engine room for the business, and being willing to invest in new concepts and product development.

Ignite 2 is the transformation programme that we are using to drive momentum in the business. The project office we established last year and the governance around monitoring the 43 different initiatives we have running is beginning to bear fruit, and it's not just in terms of driving sales; it's also in terms of improving efficiency.

In terms of sales, as I said earlier, we can now claim to have almost three years of market outperformance. With the recent distortions of the World Cup, Beast from the East, and Easter constantly moving, it's worth noting our two year like-for-like now has smoothed some of these factors out and now sits at 5.7%.

The capital programme clearly is a big contributor to this, but so are a number of the other initiatives that we've implemented under Ignite. Let's start with capital. The aim of the programme, as I said earlier, is simply to get on to a six- or seven-year cycle of reinvestment.

This should mean that every investment we make has a chance to pay back and then create real shareholder value. At the same time, it means the average quality of our amenities is consistently rising at a time, I believe, ahead of the market, and at a time when some of our competitors are cutting back on spending.

Over the last three years, we've made good inroads into that ambition, but as this chart shows you, we still have 17% of the estate that's not seen investment in over seven years, and 146 sites haven't had investment in over ten.

So, we still have a backlog of sites to invest in before we get onto our desired run-rate, but we do feel that we've reached a tipping point where the invested sites are now helping to drive superior performance, and the tail that we now have is nowhere near the drag on the business as it was three years ago.

Our return on investments, as Tim mentioned, are also improving, as we're now no longer having to invest in sites that are in steep decline as we did with Harvester and Crown Carveries three years ago. The current uninvested sites are not in distress, but we're simply rejuvenating tired businesses that then go on and give us a good return.

It's worth noting that the 549 businesses remodelled over the last four years – this doesn't include the conversions – are collectively generating a return on investment of 26% as a four-year run-rate.

Intelligent pricing is clearly key in the market, given the levels of cost, but you simply can't just pass on the price to consumers. So, we work hard to protect our entry points, but at the same time, ensure that we have sufficient premium products for which our customers can trade up. This still represents great value for money.

We do two big liquor surveys by site each year that allows us to take a very local view to pricing, but it's fair to say as one of the biggest operators, as soon as we move price the market tends to follow.

Through Ignite, I think we've become far more sophisticated in our approach to pricing. We can spot any market outliers very quickly and can put that right. We've refined our price laddering within our liquor business, and we've made our menu pricing models, again, far more sophisticated than they were.

We know the consumer is willing to spend on quality, so we try to accommodate that by ensuring there's premium products which consumers can trade up to in each of our formats. At the same time, we've worked on our promotions, moving away from what I would say was a scatter-gun approach to being far more targeted and tailored in the promotions we run, facilitated by our CRM system.

On top of these drivers of sales, Ignite has also spawned far greater local ownership for driving sales. All of our general managers have had training in their refresher or sales workshops. We now have sales managers focused on selling some of our key sites.

And we have a current initiative under Ignite 2 called Everybody Sells, which with 150 million transactions a year, it's very clear that if we can get some incremental selling going on, that could be worth a big number to us.

We've had table management software up and running in the Restaurant businesses for a couple of years now, and we've seen our online bookings triple in that time. So, we're now rolling out third-party sales software to our wet-led businesses to help facilitate group bookings.

However, I do believe perhaps the biggest foundation for driving sales has been the investment in reputation.com as a tool for our managers to engage with our customers on a daily basis. As I've said before, this piece of software collects all feedback from third parties like Facebook, TripAdvisor, Google, etc, and we've recently added complaints onto that platform too.

What it does is it means that the team get a first and immediate feedback in the moment from their customers, and it's speeded up our ability to address any issues that then arise. My belief, as our customer satisfaction scores have increased, which now sit at over four, year-to-date, there has been a clear correlation to our improving like-for-like.

Sales have been in good shape, but given the cost headwinds, we also clearly have to focus on our efficiency too. Labour remains our biggest cost, and as a hospitality business, we need to be very careful, as we look to drive efficiency into labour, we don't impact on the service levels we are providing.

Now, we changed our labour rostering tool 18 months introducing something called Team Plan, and we're now far better placed, I think, to control and understand the deployment of labour. Our technology has improved many facets and processes that we use on a day-to-day basis, but it does need people to embrace that technology before you can really yield the benefit from it.

And that's been the case, I think, with Team Plan too, because we've now become far more confident in the rotas that Team Plan suggests, and our actual schedules are far closer to the theoretical than they were maybe a year ago.

To help the deployment and usage of Team Plan, under Ignite we have an initiative called TAG Team, which is Team Plan Action Group – very creative – where we simply pair the best users of the system with those general managers and those sites that struggle to find any efficiencies in their deployment.

The results have been almost immediate, with an annualised £2.4 million of savings, and, of course, a happy added benefit while being run by operators, it's sort of owned by operators, so it's almost self-generating. Just an example of one initiative under Ignite that clearly is bearing fruit.

Ignite is also looking at cash purchases, and as previously announced, we've found a non-cash solution for day-to-day expenses that businesses need to meet, so things like emergency food purchases, taxis, and flowers.

Six months in, we've step-changed the costs going through these lines and we've generated a real 15% cost savings just simply by using M&B's buying power and maybe shining a light on some costs that perhaps didn't have the same profile before we started this initiative.

Now, we have several cost projects under Ignite looking at small weekly savings that in themselves don't look particularly interesting, but across 1,600+ businesses, seven days a week, 52 weeks a year, they add up to a large amount. More evidence, as I've said before, that there is no silver bullet, but instead the aggregate value of many initiatives begins to make the difference, and I think we're beginning to see that come through.

So, we have real momentum, but we recognise we cannot let up, and looking forward we know we still have to expand our work on our stock system, which is proving to be very complex, but will undoubtedly drive further sales opportunities as well as reducing wastage.

We also have a huge programme of work going on under our digital workstreams. If you think about it, in the last two or three years we've embedded table management; we've established brand apps; we've overhauled our websites; we've introduced cashless payments; we've successfully trialled pay at table; we have a new CRM system; we have 170 sites up and running with third-party delivery partners; we have order at table live at O'Neill's and about to roll to other businesses; and we're trialling our first cash-free business.

So, the pipeline of activity does not slow down, and the next major breakthrough will be to open up our platforms to allow very quick integration with third-party software.

The aim here is eventually to have a seamless experience for our customers so that they can select their preferred site and time, pre-order if they want to, know where they're going to be seated, and enjoy a personalised experience in control of their journey, be valued for their custom, and be informed about the things they want to be informed of after they've visited.

So, this is no longer a pipe dream, and the digital workstream is focusing on putting the building blocks in place that will enable that to happen.

We also open our first Miller & Carter in Frankfurt, Germany next month, and, if successful, that will clearly open up potential for further expansion across other German cities. And we're also about to open a new concept in Harpenden, seeking to provide a premium offer capable of genuine flex through different pay paths, hence, extending its trading capabilities. Both these developments are evidence of our willingness to invest in new concept and market development.

On accommodation we've been fairly silent on in recent years, certainly in my time, we have over 900 rooms under our Innkeeper's Lodge branding, but there's been very little brand consistency, and in truth, we know it's always been seen as the secondary part of the business.

So over the last 18 months we've been quietly refurbishing that room stock so that our minimum standard should take us to the top end of the budget accommodation, and at the other end, in our top locations adjacent to Miller & Carter and Premium Country pubs, we'll have a high-quality boutique room feel in our refurbishments.

We are committed to completing that refurbishment programme at the end of the next financial year. We've also changed the management system that we use for supporting sale of our room stock, and once that refurbishment programme is complete we will re-launch the product for the market. It's worth noting that we'll open our first new-build accommodation block in Edinburgh this year with a 74-bed hotel opening up adjacent to a Vintage Inn. So, there's a lot going on.

In summary, I can say that at the half-year, we're very pleased with the progress we're making. A little bit frustrated over the lack of clarity and the macro landscape, but we're confident we're working on the right things.

We continue to pay down our securitised debt and our pension commitment, which is creating real shareholder value, as Tim demonstrated, and now we have operating profit in growth, this is accelerating. It's worth remembering that in the three-and-a-half years that I've been CEO, we've already paid down £213 million of net debt and £167 million of pension contributions.

The second half headline growth will be more volatile on a weekly basis, due to last year's World Cup and the hot weather, but we believe we now have underlying growth and a programme of activity that should be able to maintain it.

So, thank you for listening.