Mitchells & Butlers plc
Q3 Interim Management Statement
Thursday 21 July 2011

Q&A Session

Douglas Jack - *Numis*

Good morning. Just the first one - at the interim result you reaffirmed your commitment to increasing margins by 300 basis points by 2014 - are you still standing by that target given what you're saying about the second half?

Tim Jones, Finance Director

Yes, we are, Douglas. I mean, obviously this knocks us back a bit. At the interims we were slightly behind on a year on year basis as well, but in terms of a medium term target with that range to 2014, then that is still a commitment we're holding ourselves to.

Douglas Jack - *Numis*

Thank you. And just a second question - in terms of the like for likes at 2.8% the Peach tracker was at 3.9 for June, and obviously the period you're talking about covers the second half of May and the first half of July. Could you just talk about the trend within the nine weeks - for example, was May and, say, July slightly better or worse, or how would you see it in terms of the three months?

Jeremy Blood, Interim CEO

There's a lot of noise going on, so it's very volatile. I think the end of May was quite weak, June was so affected by the bad weather and World Cup, and July it's been, again, sort of volatile. So we've been very careful in stripping... you can imagine, we've looked very carefully at this to discern the softening. But it's quite clear that there is a softening, but it remains volatile and quite weather related at the moment.

Douglas Jack - *Numis*

Thanks very much.

Matthew Gerard - *Credit Suisse*

Hi, good morning, guys. Just following on from Doug's question on margin then over the medium term - I mean, the implications of what you're saying today are, I suppose, that we're losing 8 to 10 million on full year forecasts. Is there any reason why the annualisation of that shouldn't impact FY12, ie, we're expecting a 20 to 25 million shortfall on EBIT rolling through to FY12? Or are there new cost savings that you've not previously identified, that you are this morning? And I suppose what are they if you have?

Tim Jones, Finance Director

There are cost savings we're looking to generate in purchasing savings, but to answer your question directly this isn't about one-offs that are hitting us now; it's about ongoing trading conditions. So I think it's quite sensible to assume that there is going to be a knock-on impact on next year. That 1% that we're talking about in our statement is our current estimated run rate - we don't think that is going to pick to the two's or three's that people had in at the beginning of next year, so I think there will necessarily be that follow through impact on next year.

Jeremy Blood, Interim CEO

But I don't think you can multiply the effect quite straightforwardly, because there will additional savings and then there's lots of good initiatives and good flow through in a variety of things. So it's not a straightforward; we're not flagging up a straightforward multiplier from these 12 months annualised.

Matthew Gerard - *Credit Suisse*

And just following on from that - if you look at the returns you're getting from your investment to date and you backed that out, can you give us a bit of colour on the performance of un-invested assets?

Tim Jones, Finance Director

Yes. Un-invested sales are obviously lower than the 1% we're talking about here; that's closer to flat, and the rest sort of coming through from a lot of the returns we're getting on the investments.

Jeremy Blood, Interim CEO

In terms of profitability for this financial year, the overall mix by the time of acquisition openings and the time you've paid the costs for the design fees, the recruitment fees and the pre-opening costs and the conversion activity, it's pretty neutral on the P&L in the first year in which you make the step up, I think as we tried to explain it at the interims. So it's not that -- these numbers are not flattered by the expansionary capex this year.

Matthew Gerard - *Credit Suisse*

Okay, thank you.

Jamie Rollo - *Morgan Stanley*

Thanks, morning everyone. Could you just elaborate on what the additional sales and operating initiatives are that you're doing, and why those, plus the additional promotions, aren't boosting your top line, please?

Jeremy Blood, Interim CEO

I think they are improving the top line. I think the increased promotional activity we were running at... we're not now, we've turned the dial up significantly but not dramatically on voucher and promotional activities in a number of brands like Toby, Harvester and Sizzling.

Why aren’t they dramatically changing the line? I think we’re just in a more competitive environment; I think everybody is being more competitive out there, so I guess you’re in a competitive environment so it’s not a zero-sum gain in that respect, so there’s increased promotional activity.

We are still, I think, below the benchmarks of others, some other restaurant operators and we are retaining very clear discipline in terms of putting these in for short periods of time and then pulling them. So we’re not becoming addicted to voucher activity in any sense, but we have turned the dial up.

In terms of sales and operational initiatives I think two things - the two examples that I would give, they’re not the sole ones. We have, and I think it’s been flagged up at the interims, but we’ve actually even pushed it faster - we've rolled out the breakfast right across about 500 of the larger pub restaurants in Harvester, Crown and Toby. That’s the absolute right thing to do. We’re getting incremental visits, occasions and meals out of that activity.

What we are finding is in the first eight weeks when you roll out breakfasts it takes time to settle down the labour ratios, settle down the wastage ratios. So it’s slightly dilutive activity during the first eight weeks while you establish the breakfast. But we’re confident that it is clearly profitable and that the units which have been doing it for the longest are making a very clear profit at a full costed level. So it’s a great initiative and it’s a good sales initiative for the business. So that’s a good example.

On operational initiatives - I suppose one thing I was particularly thinking of when we were phrasing it that way, is we’ve been looking hard at the adequacy of our kitchens to meet the increased food demand. So we’ve been spending particular focus and revenue activity in the kitchens to make them fully fit for purpose as our food sales go up. And again, I’m very confident to stand by that that’s the right thing to do. It will help us keep volumes and quality going forward over the next 12 months.

Jamie Rollo - *Morgan Stanley*

And on the promotions across the industry, you wouldn’t go so far as to describe the situation as like there’s a mini price war out there?

Jeremy Blood, Interim CEO

No, I don't so, but I think everyone is reacting to a... bluntly it's just a bit harder to get people off their sofas at the moment. We're finding that when we get people in, that they're happy to drink, so we just need a little bit more activity to pull people in, and a little bit more direct activity. So rather than maybe advertising, move some more of the spend to real call-to-action stuff like promotions. And I think it's just a little bit... it's adjusting your tactics appropriate to consumer feeling at the time - consumer sentiment.

Jamie Rollo - *Morgan Stanley*

Okay. And if I can just ask about costs for 2012 - could you just give us a feeling for... just aggregating everything together, either what the percentage increase in operating costs will be, or just give us it in millions of pounds. Or indeed, if you can give us a flavour of what like for like sales you need to hold margins flat. Any combination of those would be helpful.

Tim Jones, Finance Director

I think we normally assume, without major cost savings, that we need about 2% of like-for-like sales growth to hold margins flat and pay for the wages going up, etc. etc. and duty. I think our current view is that that's probably... we'll probably undershoot that a little bit next year on a full year basis, given that we're likely to enter at slightly less. But we have got a number of initiatives that we're looking at, as you'd expect, to reduce our cost base and to reduce our purchasing as well.

Overall, Jamie, I think we hope that we can at least hold the margin that we've got, that we'll expect to report this year for next year, or even make a slight improvement on it, but we don't think it should go down next year.

Jeremy Blood, Interim CEO

Certainly, if this like for like trend continues in H1 and it's a slightly more benign H2 then we'll certainly hold things. If it's worse it will be harder to do that and we'll have to look at costs even harder, and if it's more benign then we'll do a bit better - that's where we are.

It is difficult to be precisely accurate at the moment because it's an uncertain consumer environment.

Jamie Rollo - *Morgan Stanley*

I appreciate that; thank you very much.

James Ainley - *Citi*

Yes, most of my questions have been asked already actually, but could you just give us a little bit more colour on specifically what kind of cost inflation you're going to see on some of the underlying items next year - so specifically food and energy I guess I'm thinking of.

Jeremy Blood, Interim CEO

I don't think there's a big change to the interims but, Tim, do you just want to reiterate…?

Tim Jones, Finance Director

I think food, our experience of food cost inflation is running at about 4% at the moment - we think that's some way below what the market is, but that's what we're experiencing, so that's what we're building into our projections.

The oil price will determine our energy. I think, as we talked about the interims, we have a lagged impact from the oil price because we don't do any hedging but we do do a measure of forward buying. So we'd expect up to about a ten million year-on-year increment next year if the oil price stays where it is at the moment.

And then a lot of the other costs - I think you guys are all well aware of net minimum wage, which seems to be going up around about 2% at the moment, we'll factor that into our plans. And of course, there's duty that we know is going to go up by a couple of percent in real terms as well.

James Ainley - *Citi*

Okay, thanks.

Simon French - *Panmure Gordon*

Morning guys, just a couple from me, please. First on the expansionary capex for next year - I think you've guided previously towards to 90 million of expansionary capex for FY12. Any plans to rein that in a bit given the consumer environment?

And then secondly, just on any non-core assets you may have left, some of the franchise pubs or maybe the Alex business in Germany? Any further progress on disposing of those, please?

Jeremy Blood, Interim CEO

I'll do non-core quickly. There is no plans to dispose of anything; we're quite happy with what we've got and I think we can get more -- indeed, some of the non-core things, I think Germany is a more benign environment and the German business is performing well, and we're confident about that. And some of the franchise businesses, I think we believe is a clear opportunity to focus a bit harder and we get a bit more value out of those. Tim, on capex expectations for next year and our approach to it?

Tim Jones, Finance Director

We won't really change our guidance on next year's capex at around the 90 that you quoted. I think, as Jeremy said at the beginning, you know, we're carrying on with our capital plan, it's generating value, we're sustaining 20% returns out of it, and so we're planning to continue to do that unchanged through next year.

The only caveat is, of course, we need to keep that under constant review, and if we felt that things got so tough that it was better to rein back on that then we wouldn't be afraid to do that. But that's not our current plan.

James Ainley - *Citi*

Okay, thanks very much.

Paul Hickman - *Peel Hunt*

A very good morning. Two questions actually - firstly on trading. Compared with the trading uplift in the first half at EBIT level that you presented as 16 million, it seems that we're now being knocked down to quite a small figure. Now, I take the points about capex and current year effect, but what about, firstly, the effect of last year's capex. And secondly, this was supposed to be a higher quality set of assets that you now posses - what kind of benefits are you seeing from that factor? And what other kind of benefits, other than simply promotional actions, have you thought about introducing? So that was question one.

Question two - can you make any comment today about the Board structure?

Jeremy Blood, Interim CEO

Thanks Paul. On trading I'll hand onto Tim on that half one, half two precise points, but I think you're asking about what other things we're doing, and are these a higher-quality set of assets? They are a high-quality set of assets and we are driving positive like for likes from these. We continue to outperform the market and I would anticipate we would outperform the market.

I think our ability to drive spend per head, our -- the work we're doing to strengthen the performance and capacity of our kitchens to really deliver these stronger food offers will deliver, will pay dividends. And brands like Harvester which I highlighted at the interims are still performing extremely strongly. So we've not lost confidence in the quality of the assets or the momentum of the business we've got. We're just seeing stiffer headwinds.

The second thing you asked was about the Board situation; this is a trading call so we're not proposing to discuss it. It's clearly a fact in investor's minds that the Board, over several years hasn't been as stable as one would wish. That's clear. We would like it to be stable. We're a fully functioning business, a full functioning Board.

My position - I was asked by the Board to do the Interim CEO role in March and my position is completely unchanged as regards that, and we had a very effective executive meeting yesterday where we're getting on with the business. So yes, it's there in the background, but I think it's not affecting the focus and performance of the business right now.

Tim, do you just want to try and help Paul tease out some of those numbers?

Tim Jones, Finance Director

Yes, Paul, I think to go back to the interims - everything we talk about now is very consistent with that, with the proviso that obviously we're saying that there's been maybe an incremental step down in the level of demand and some increase in cost pressures that we're facing.

Speaking to the strength of the estate etc., we are fairly clear that we are outperforming our market - not every single other operator - but we are outperforming the market in general, so we are still performing well within that context. We need to respond to the slightly tougher environment we've got now by further digging out what cost we can, and that will come through looking at our organisation, looking at how we run our organisation, and looking at what we purchase, in terms of our input costs. All of those are actively being pursued, as you would expect.

Paul Hickman - *Peel Hunt*

Thanks.

Geoffrey Collyer - *Deutsche Bank*

Hi, morning guys - I've got a couple of questions. I don't think you've actually given us the second half margins for the Retained Estate for last year - I'm just trying to see what that is so we can actually work out what's happened to the H2 margin against the underlying margin from 2010?

Tim Jones, Finance Director

18.5%, Geof.

Geoffrey Collyer - *Deutsche Bank*

It was 18.5% last year, okay.

Tim Jones, Finance Director

15.5% in the first half, 18.5% in the second half, 17% for the full year.

Geoffrey Collyer - *Deutsche Bank*

Okay, thank you. And then you talked at the back end of last year and this year about really strong uplift, instant uplift from ad spend. So given the fact that you're seeing trading under a bit of pressure I'm surprised that you seem to be moving more towards new couponing and discounting, rather than frontline TV spend - could you make a comment on that?

And then the final question is that we've seen in recent weeks a lot of discussion about... in the supermarket trade with a lot of movement at the bottom end of the market in terms of demand, and a lot of movement at the top end, and quite a soggy middle. Could you talk about what's happening actually inside your own estate in terms of different levels of demand?

Jeremy Blood, Interim CEO

That's a good question, Geof. On the balance between advertising and promotional activity, I did say we've turned the dial slightly more towards promotion, and you question how sensible that is. I think on a brand like Harvester, where we've got good brand penetration, good brand recognition and a strong, clear proposition around salad and grill, the advertising is proving effective in brand building and extremely... a good way to spend it, and I think that will continue.

On other brands we're finding that a direct call-to-action through vouchering activity is more effective. Perhaps it won't achieve quite the same effect in terms of long term brand building, but I think at this point in the cycle it's right to prioritise volume and visits slightly ahead of brand building. I don't apologise for that; I think it's very much how the grocers balance their sort of press/TV activity, and I think it's just a natural way of managing your marketing spend.

On how we're seeing it, trends within the business - strong regional splits, still London doing well, North suffering. I wouldn't recognise it quite so much that the bottom is doing better than the middle. For us, our middle brands are proving extremely robust and popular - Harvester continues to storm away.

I think we are seeing, right across restaurants, we're seeing some slight trading down from full service all the way down to pub restaurants and things like that, so I think we're still benefiting from that trend in the middle. In the more upscale stuff there's not a huge... it's robust, especially in the South East and it's pulling people out. When they're in there they're spending fine. And then finally, I would say... that's particularly, that's because of the World Cup effect, we are seeing the drinks business a bit tougher in the bottom end, and again in the North tougher again. Does that help?

Geoffrey Collyer - *Deutsche Bank*

Yes, thanks very much.

Ian Rennardson - *Jefferies*

Good morning. Talking about margins - you've got a target, or you're hoping for flat margins in 2012, you've got increasing costs, you've got... momentum in sales is slowing, you've got the consumer under pressure with household spend down something like 5% in June. Specifically in 2013 or 2014 where do you expect that 300 basis points of margin improvement to come from? And given where we are wouldn't it be better to step away from that target until we have a new permanent CEO who can make his own mind up?

Tim Jones, Finance Director

It was 300 improvement from when this target was first cited 18 months ago; it's not 300 improvement from the level I'm talking about this year and next year. We're probably going to be around 16.5, something like that, the commitment we gave was up to 17.3, so there's slightly less than 1% improvement. Your point is well made though. It's a lot easier to achieve that when sales are running away than when we've got cost pressure and softening sales.

I'm not just saying it, there are a number of issues we're looking at - one that we've already done, for example, is we've looked at our logistics internally and we've let a new contract on that. That will have a little bit of an impact in the second half of this year and will annualise up to next year, so that's going to help us a bit. We've looked at our IT infrastructure and some work that we're doing with an external third party that's hopefully going to bring us some cost savings on a full year basis next year as well. So there are initiatives we're doing to take down the cost structure of the organisation. From what we see and from what we think we can get out of those plans, you know, our current view is we can hold that margin constant at the lower like-for-like. And then as the like-for-likes hopefully increase in '13, '14, we're looking to get up to the extra percent to get into the target range.

Jeremy Blood, Interim CEO

And your second point was should we wait for a permanent appoint to be made - I don't think that's necessary. The strategy is really clear, the business focus is clear, these decisions are not solely an individual's, we're all working as a team on this one, we're very confident about the cost initiatives we've got in place, we are very confident about the momentum and development of our food business - I don't think there's a merit in pressing a pause button on a business like ours.

Ian Rennardson - *Jefferies*

Okay, very clear; thank you.

Kate Pettem - *UBS*

Good morning. I'm wondering if you could split out the contribution of breakfasts from within that like-for-like. It seems curious to me that if you're sweating the assets harder and you're spending on promotion to drive footfall, that really you expect a very poor underlying trend at the beginning of next year, and I'd like more colour on that, please?

As well, you haven't talked much about Vintage Inns and Premium Country Dining - I'm wondering there if the meal price, average meal price, may be a little bit high for customers with people seeking value brands, or if those brands are still absolutely core and driving strong sales? Thanks.

Jeremy Blood, Interim CEO

Kate, there's a number of questions there - can I pick up Vintage and PCDG first. Yes, there was no deliberate focus not to talk about them. Vintage, certainly I don't feel that price is a barrier there; we're fine on that one. PCDG is higher priced but, again, the absolute sales there are fine. We monitor guest satisfaction and value for money very carefully and we're not seeing a downturn in those. In the most recent period, both of those brands have got a lot of gardens and we've seen three wet Sundays, I think, out of the last four or five, so they've had a slightly soggier, literally and financially, performance. But the brands and what's underpinning the brands is very strong. The openings of those are performing well, so we certainly don't see them as being more vulnerable in that sense.

Sorry, I didn't scratch down the first question - Tim do you want to...

Tim Jones, Finance Director

Did you ask about breakfast?

Jeremy Blood, Interim CEO

Breakfasts; sorry, yes.

Tim Jones, Finance Director

On an annualised basis, so when we get to next year, we'll probably generate just over ten million of sales revenue from breakfasts, or slightly more, so that's worth around about 0.5% on like for likes. At the moment that's coming through at a fairly thin margin for us, whilst we get to grips with what hours we should be open, the labour usage we've got behind it, and the wastage and what have you. But we'd expect that margin to get richer as we get more professional about how we deal with it, and we expect to grow further revenue over time as well.

Takeaway, that you also mentioned, is a little bit at a lower level at the moment, that's only really in Harvester and that's not reached anything like the scale that we're doing breakfasts.

Kate Pettem - *UBS*

Okay. Tim, do you expect the margin in breakfasts to be more or less in line with group margin, or is that margin going to...

Jeremy Blood, Interim CEO

For the brands we're operating breakfasts in, the gross margin before wastage is enhancing to overall margins, so we're confidence that it should get to the right place. What you're doing, when you're building sales, it's very difficult in a buffet-style sort of breakfast that we're operating; it's very difficult to accurately get wastage. So I never thought I'd have meetings on mushroom wastage but that's what we've been having over the last few weeks, and getting those things nailed down. It really is the nitty gritty of operational performance.

But where it’s most established we’re clearly seeing good, sustainable GM, it will just take there... what we are very pleased with is the persistence and consistency of the sales levels. It’s just sorting out the margin, and that's what you’re seeing a little bit, and that’s why it won’t make up -- it will make a positive impact to sales, but it won’t make a positive impact to -- it will have a dilutory effect on margin this year, and that’s one of the features in the IMS.

Kate Pettem - *UBS*

Thank you.

Jeremy Blood, Interim CEO

Great. If there are other questions I’m sure you won’t hesitate to get in touch with us over the course of the next day or two, but thanks everyone for their attention, thank you for the questions. The key summary for us is we do detect some softening, we think we’ve taken the appropriate trading response to that softening, but it’s certainly not a dramatic change in our trading approach, but just an appropriate change in it. And the underlying strategy of value enhancing, capital rollout and a focus on costs and margin improvement remain in place, just against slightly stiffer headwinds. Thanks very much everyone.