Langton Capital Limited

26 Nov 2013

MITCHELLS & BUTLERS (MAB): 419p
FY Numbers for the 52w to 28 Sept 2013

Shares react very positively to earnings release, focus on EPS growth rather than sluggish (for the moment) LfL sales

Year to end-Sep	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2012 (A)	83.0	30.5	12.8	Nil	Nil
2013 (E)	184.0	34.9	11.2	Nil	Nil
2014 (E)	191.8	35.9	10.9	3.7	0.9

Source: *Company & Broker Estimates*

Full Year Numbers to 28 Sep 2013:
Following the release of its full year numbers earlier this morning, Mitchells & Butlers hosted a meeting for analysts and our comments are set out below:

Trading:
- Group admitted LfL sales 'are not where we would like' but group and market focus on wider margins and better EPS
- Wider margins clearly helped (this was driven by cost cutting rather than higher prices) but a lower interest charge & reduced tax bill also helped EPS
- The sluggish LfL sales growth 'reflects the group's concentration on its transformation' and that it has 'dialled down on promotions'
- Volume declines were around 3% but falls moderated in H2; value brands have been hit, London is up 'broadly in line' with performances at Young & Co and Fuller's
- LfL growth of 1.5% to 2% is anticipated for FY14

Business Transformation:
- Group is now 50% food and 75% food or drink with food; staff turnover is down (to 78% from 85% two years ago), the right-sizing phase is over and the group is undertaking a 'balanced transformation'
- Net promoter scores are rising and prices have been cut at Crown Carvery, for example, where volumes had been 20% down

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Market Cap: £1.6bn
12m range 298p 460p

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Debt, Cash Flow and Capital Spending

- Cash flow has been positive (£84m) before debt amortisation but positive also (at £29m) after amortisation
- Debt is down (covered earlier) and the cash accruing outside the securitisation 'is always under review'
- Some 30-35 units should open in FY14 with a move to c50 thereafter; there will be a c£2m cost of incremental new openings until the c50 per annum is annualised
- Returns are 13% on freehold (target c15%) and 18% on leasehold ('aim for 20% or even 25%')

Other Issues:

- Chairman Bob Ivell says that the Board (three NEDS, the shareholder appointees and the Executive Directors) is working well together
- Pension discussions are ongoing and need to be resolved before June next year
- The dividend 'is a consequence of other things' and 'it is the last thing to be resolved' (post pension costs and capex opportunities)

Conclusion:

- The recovery will be patchy but the group maintains it is well-positioned

Langton Comment: The market has looked favourably on M&B's trading comments and the positive news that margins have widened has more than compensated for the impact of lower LfL sales numbers than those produced by M&B's peer group.

It is also possible that the market has decided that, if M&B can drive earnings with low LfL numbers, it must be able to do much better when growth picks up.

And the group's shares are not expensive and it is well asset backed and investors are looking for value and the above has won the day. And that is not altogether surprising but M&B's dividend policy is still to be determined and its share register is a concern to some.

Whilst we acknowledge that the group has a fantastic estate, excellent brands and very good staff (and we know that we may miss this one), we would dearly like to see some further moves towards normalisation before wholeheartedly backing the company's transformation.

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