22 Apr 2015

PUNCH TAVERNS (PUB): 103.25p
H1 Results – Conference Call

Uncertainty re MRO may put off some investors but we see material potential upside going forward…

Year to end-Aug	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2014 (A)	50.8	n/a	n/a	Nil	Nil
2015 Est	57.2	21.1	4.9	Nil	Nil
2016 Est	59.6	21.4	4.8	Nil	Nil

Source: *Company & Broker Estimates*

H1 Results:

Following the announcement of its H1 numbers this morning, Punch Taverns hosted a meeting for analysts and our comments are set out below:

Trading:

- The group has now seen 7 Quarters of LfL growth
- LfL net income growth (core) was 0.5% in H1. This represents 1.7% on drink and minus 1.2% on rents
- Re outlook, central costs should reduce, trading in the non-core estate should be stable
- Comps going forward? Trading was good last year in H2, there will be no World Cup & the weather is uncertain. This is taken into account when determining comments on FY trading

Balance sheet, debt, etc.:

- The group has increased its target for pub sales this year to £80m. Some 210 pubs are currently up for sale
- Re 'gold bricks', disposals are typically London and they are opportunistic. Numbers are 'tens rather than 100s'.
- The target is still to invest c£100k in 400 pubs. In the last 6mths, the group has invested an average of £106k in 122 pubs
- As a result of the MRO, investments with a longer payback period (typically over 5yrs) have been put on hold. These are limited in number but are typically >£300k
- Group reiterates its target to reduce debt by £200m over 3yrs

Find us at:

Recent News Here:

- *Today's email*
- *Recent emails*
- *A day in the life...*
- *Who we are, what we do...*
- *Upcoming news-flow*
- *Recent company updates*
- *Thematic pieces*
- *LinkedIn profile*

Market Cap: £228m
12m range 87p 290p

Mark.brumby@langtoncapital.co.uk
Suite 415, No1 Alie Street, London, E1 8DE
020 7702 3389

Strategy, development, restructuring etc.:

- The core estate now comprises 90% of profits, up from 75% in 2011. Core units generate 2x the profit of non-core units
- The group has sold 1,600 pubs since 2011 and the non-core estate has been reduced by 24% in the last 12mths
    - Non-core still provides £12m of EBITDA
    - Group will exit pubs that do not fit the model – for example, if they are earning less than £25k p.a.
    - Punch is 2/3 of the way through its disposals
    - In H1, it sold 37 core & 112 non-core units at an average EBITDA of >20x. The £57m of receipts is £12m ahead of book
- There has recently been a move away from longer leases & back towards shorter term tenancies. Currently c2/3 is leased & 1/3 tenanted.
- New publicans tend to wish to minimise fixed costs – and therefore go for low rent, high beer costs. This may evolve over time as the publican becomes more confident in his pub
- The group's c3,700 pubs should reduce to c3,000 over time
- Group 'needs to' put in place a managed capability. Franchising is also 'in its early days'

MRO & legal changes:

- Says it could be another 12mths before the situation is clear & observers suggest 1,000 to 2,000 pubs could close
- Group has taken some actions. It is considering its ability to manage and franchise some of its units & is looking at free-of-tie leases. It 'will update further in due course'.
- It has not yet ruled out a legal challenge under European human rights legislation; group won't go into further detail at present
- Group says around 2/3 of units are 'at risk' but changes will occur on review or new-lease. It sees the changes as 'negative but not quantifiable at this stage'

Conclusion:

- Says debt structure is robust & sustainable. Leveraging will be reduced further. The group will evolve in order to best cope with MRO changes though, at this point, these changes are not yet definitive

Langton Comment: Punch has managed to reassure that trading is in line with expectations and disposals are ahead.

H2 comps will be tougher, uncertainty remains as to the impact of the MRO legislation and, with the best will in the world, there's very little that can be done about that. This may put some investors off but it is what it is.

However, Punch looks set to evolve its model. It 'needs to' put in place a managed offer and it is also looking at franchising.

Mark.brumby@langtoncapital.co.uk
Suite 415, No1 Alie Street, London, E1 8DE
020 7702 3389

Elsewhere, disposals continue, debt is falling and the capital structure is ‘robust & sustainable’.

Earnings numbers suggest that the group is cheap but, with the business model in flux, they are likely to change over time.

We would suggest that there is material upside potential within Punch. Profits can move quickly when they are the difference between two large numbers (EBITDA + interest paid) and we believe that trading is stabilising.

Punch’s shares may remain out of favour until we have some certainty as to the MRO. However, its shares will comprise a large part of the small cap index and, as such, the upside represents a risk to non-holders who are benchmarked against it.

We would suggest that the shares are worth a look.

Contact – Mark Brumby - +44(0)20 7702 3389

mark.brumby@langtoncapital.co.uk

This message (and files contained herein) may contain confidential or proprietary information and is intended solely for the use of the individual or organisation to whom it is addressed. If you are not the addressee you should not disseminate, distribute or copy this email or any part thereof. Further, please notify the author immediately by telephone or by replying to this email and then delete all copies of the correspondence from your system. We apologise for any inconvenience that this may have caused. This information is a financial promotion for the purpose of the European Markets in Financial Instruments Directive (MiFID) and FSA’s Rules. It has not been prepared in accordance with the legal requirements designed to promote the independence or objectivity of investment research. This document is not based upon detailed analysis by Langton Capital of any market, issuer or security named herein and does not constitute formal research or a research recommendation, either expressly or otherwise. It is not investment advice and does not take into account the investment objectives and policies, financial position or portfolio composition of any recipient. This document should not to be relied upon as authoritative or taken in substitution for the exercise of you own commercial judgment. Whilst Langton Capital has taken steps to control the spread of viruses on its systems, it cannot guarantee that this email and any files transmitted with it are virus free. No liability is accepted for any errors, omissions, interceptions, corrupted email, lost communications or late delivery arising as a result of receiving this message via the Internet or for any virus that may be contained in it. Recipients should review independently and / or obtain independent professional advice and draw their conclusions there-from should decide to undertake transactions with third parties. Langton Capital or its employees may have positions in securities mentioned herein. We reserve the right to monitor email messages passing through our network. Langton Capital Limited is authorised and regulated by the Financial Services Authority. Langton Capital Limited is registered in England number 07112949.