30 Nov 2016

GREENE KING (GNK): 690.5p
H1 Numbers – Analysts' Meeting:

Group caution on costs lead to FY18 downgrades. Trading holding up but some concerns re next year…'

Year to end-Apr	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2016 (A)*	189.8	69.9	9.9	32.05	4.6
2017 (E)	277.0	71.8	9.6	33.70	4.9
2018 (E)	280.0	73.0	9.5	35.00	5.1

*Source: Company & Broker Estimates, *including part-year Spirit*

First Half Numbers – Analysts' Meeting:

Following the release of its H1 numbers for the 24wks to 16 October this morning, Greene King hosted a meeting for analysts and our comments are set out below:

Full Year Numbers:

- The numbers were a H1 record, GNK has pointed out that all divisions are in profit growth
- Integration of Spirit is 'ahead of schedule'

Managed Houses:

- LfL sales growth was 1.3%. Ex Fayre and Square, which has been a drag, LfL sales were +1.9%
- Tougher areas at the moment include 'blue collar food'
- F & Square number have dropped (on conversion) from c150 to c100. By the end of 2018, the brand will have gone
- Returns on capital spent on conversion are 15% to 20%
- GNK opened 7 new units in H1. The group also disposed of 7 pubs
- Margins slipped from 18.6% to 18.1% & GNK is guiding for them to fall a little further
- Utility, forex, NLW, NMW, business rates, F&B costs will all impact FY17 and, more so, FY18 numbers

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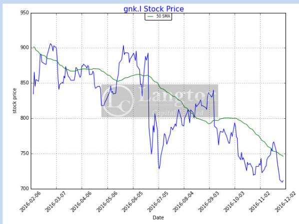

Market Cap: £2.1bn
12m range 690p – 978p

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- Spirit synergies, already raised to £35m, should exceed that number
- The group does not intend to push prices too hard. It will seek to mitigate cost increases where possible
- The cost environment is 'spiky'
- Home delivery is peripheral. GNK, along with most pub operators, would rather persuade customers to leave their homes for a night out

Leased & Tenanted:

- LfL EBITDA is +4.2%. Some 3 units were sold in H1 and 45-50 will be sold in the full year.
- The MRO experience to date is 'in line with expectations'. There have been 24 requests as to Free-of-Tie options to date

Brewing & Brands:

- Brewing had a 'relatively difficult year'. It still outperformed the industry but, as unprofitable contracts were cut, sales fell
- Margins, however, are better and profits are up. Selling O S Hen for £1 a bottle was perhaps not good for the brand image
- Marketing hasn't been cut back

Cash Flow, Balance Sheet & Debt:

- GNK reminded analysts that its Spirit debentures pay 8%. The group should be able to re-finance, albeit not for free, at nearer 4%
- Debt to EBITDA rose from 3.9x to 4.2x. It should remain near that number going forward.

Market Conditions, Strategy and Other:

- CEO Rooney Anand quoted MCA data suggesting that the managed market should grow strongly over the next 3yrs whilst revenues of tenanted & leased pubs will decline (in total)
- This will be partly due to more of the former and fewer of the latter. New entrants may take share.
- GNK aims to be the no1 pub company in the UK. Whilst the co is absorbing Spirit, it is very much BAU (business as usual).
- Re integration of Spirit. The group has made 'great strides' since the teams were brought together in May this year. The decision to relocate some pub company operations to Burton 'was not taken lightly'
- The timetable for brand conversions has been extended. This is to balance demands re staff, cash etc. and is also partly a response to the 'turbulent environment'
- Overall, the short term is secure but there are some uncertainties as to costs and demand from mid-2017 onwards
- Some unexpected cost increases, the scale of the change in business rates, utility & some F&B costs, which will be partially mitigated, will lead to reductions in FY18 forecasts

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Langton Comment: Greene King has conceded that costs are rising more rapidly than anticipated and says that the conversion of ex-Spirit sites will take longer than initially planned.

The former is because of external events and will impact the industry rather than GNK alone.

The latter may make sense but, overall, the factors outlined above will lead to lower margins and estimates for FY18 have come down.

Nonetheless, we would suggest that GNK is one of the UK's better-positioned pub companies and, with its shares now trading at a single-digit multiple, it is not expensive. Affordable treats will remain, well affordable and there is something to be said for getting out of the house.

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