Langton Capital Limited

26 Nov 2015

MARSTONS (MARS): 159.5p
Full Year Results – 52wks to 3 Oct 2015

Group reports it has a high quality pub and beer business delivering strong profit and returns growth'…

Year to end-Sep	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2014 (A)	83.0	11.70	13.6	6.70	4.2
2015 (A)	91.5	12.90	12.4	7.00	4.4
2016 (E)	99.0	13.75	11.6	7.35	4.6

Source: Company & Broker Estimates

Full Year Results – 52wks to 3 Oct 2015:

Marston's has this morning reported preliminary full year numbers for the 52wks to 3 October and our comments are set out below:

Financial Results:

- Group has reported underlying Group revenue up 7% to £845.5m
- Underlying PBT is up 10% to £91.5m. Underlying EPS is +10% to 12.9p. The final dividend is +4.7% at 4.5p taking the year total to 7p (+4.5% on last year)
- The group has seen 'profit growth in all trading segments despite disposals'

Cash flow, balance sheet, new openings, debt etc.:

- Operating cash-flow is up £34.5m to £162.3m and debt to EBITDA is down by 30bps to 5.1x
- Some 25 new pub restaurants have been opened this year
- More Taverns have been converted to Franchise, the group now has c550 Franchised pubs in operation
- The quality of the Leased business has been much improved. The estate is now in LfL profit growth and rents are up
- The Tenanted operation has delivered an increase in average profit per pub of 15% in 2015 (due in part to disposals) with the profit contribution on average up c40% since 2012

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Market Cap: £918m
12m range 139p 174p

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Divisional trading, costs, margins etc.:

- The group updated on divisional trading on 14 October and recent sales trends are shown below:

Period	Premium & Destination LfL sales (%)	Taverns LfL sales %	Leased LfL EBITDA %	Beer Company Volumes %
H1 12/13	n/c	'down'		+12.0
FY 12/13	+2.2			
H1 13/14	+5.7	+3.8	+3.0	Slightly lower
FY13/14	+3.1	+2.1	+3.0	
H1 (26w) FY14/15	+1.5	+1.4	+4	+4.0
FY14/15	+1.8	+2.0	+4.0	+5.0
Last 11wks of 14/15	+2.2	+3.1	Not given	Not given

Source: Company Reports, m/f = managed & franchised

- Re the first 7wks of FY16, the group says 'the year has started well, with both pub trading and beer volumes in line with expectations.'

- Marston's says 'at this early stage in the year we remain confident of achieving our targets for the full financial year and are on track to complete the new-build and lodge expansion plans'.

- The group, which has reported a 30bps increase in margin 'through a disciplined approach to discounting and tight cost management' says that the financial impact of the NLW 'compared to our existing plans, will be moderate'

- MARS says 'our focus will centre on improving the quality of service to mitigate further the impact of the cost increase.'

Strategic issues:

- MARS points out 'since 2013, we have reduced the size of the pub estate from 2,050 pubs to a core 1,600 pubs which now substantially completes the disposal programme.'

- The quality of the estate has been markedly improved. The group says 'average profit per [leased] pub, a good indicator of pub quality, has increased to around £100k per pub, up around 40% since 2012.'

- New-build remains the group's 'key growth driver' (134 units added since 2009) but the move to Franchise has helped profits and good quality Leased units (and indeed the breweries) remain core to the group going forward

- Whilst it operates in a competitive environment and will have to fight in order to secure share, the group holds five components as key going forward:

    1. Operating a high quality pub estate
    2. Operating a range of pub brands and formats
    3. Offering value for money across all food and drink
    4. Securing leadership in the UK beer market
    5. Keeping the best people

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Conclusion:

- CEO Ralph Findlay reports 'the three year transformation of our pub portfolio towards an optimised estate is now largely complete.'
- He says 'we approach 2016 with our business successfully positioned at the forefront of industry trends with high quality, well-invested pub assets which are fit for the future.'
- Mr Findlay reports 'looking forward, we remain on track to open at least 20 new-build pubs this year and have in place a carefully selected site pipeline in key regional locations for 2016 and beyond.'
- He adds 'whilst new-build, food-led pubs remain our core growth driver, we have evolved our strategy to capitalise upon other opportunities for expansion where we see attractive returns potential.'
- Overall, Mr Findlay concludes 'at this early stage of the current year trading has begun well and we look forward to building on this momentum over the months ahead to deliver another year of good progress for the Group.'

Langton Comment: over recent years, Marston's has transformed its business.

It has disposed of a material number of tail-end pubs and has built 134 destination, food-led outlets at an attractive EBITDA multiple of under 6x. The more mature new-build units, which have already been revalued once, are likely to have put on more value.

Return on capital targets for these freehold units remain between 13% and 15% depending on location.

The disposals have materially improved the quality of the group's earnings. The group has been selling £20k per annum EBITDA units and has been adding sites that have been capable of generating £300k and £400k.

In its Group Overview, the company says that its pubs, tenanted, leased and managed combined, were contributing an average of £72k p.a. in EBITDA in 2013 and now, only 2yrs later, a smaller number of pubs in total are contributing 40% more at over £100k per pub per annum.

The disposal process has been dilutive but this has now worked its way through the system and the group will be back into earnings growth.

Margins are up at a time during which the group has been beating the market in terms of LfL sales growth. Current trading is 'in line with expectations' and, as these are for a c2% plus increase in LfL sales over the year as a whole, we would expect that something in that region has been returned in October and November.

Given that November will have been tougher than October (per M&B on Tuesday and others), this suggests that MARS is beating both the Coffer Peach Tracker and a number of its larger competitors.

It has to be said that October and particularly November are not large months and Christmas is clearly all to play for.

MARS is growing EPS and cutting its debt. Debt (at 5x EBITDA), will remain broadly level in absolute terms this year but, as earnings are growing, it should fall as a multiple of EBITDA. Fixed costs cover is >2x and is not out of line with RTN and other 'lowly geared' (but leasehold) operators.

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MARS shares are trading on less than 12x current year earnings and offer a 4.6% yield. The group is capable of delivering double-digit EPS growth into the medium term and its shares offer extremely good value.

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