Langton Capital Limited

9 Dec 13

PUNCH TAVERNS (PUB): 10.75p
Further Debt Restructuring Proposals

Group reports 'significant progress made' in discussions with bond holders, makes further proposals…'

Year to end-Aug	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2012 (A)	52.4	7.2	1.5	Nil	Nil
2013 (A)	17.0	5.7	1.9	Nil	Nil
2014 (E)	44.5	5.1	2.1	Nil	Nil

Source: *Company & Broker Estimates*

Further Debt Restructuring Proposals:

Punch Taverns has this morning released a progress update on its moves to restructure its debts and our comments are set out below:

Background:

- Punch Taverns made proposals twice this year already but these, though they have formed the basis for further discussions, have been rejected by senior bond holders
- The group says it has held 'extensive discussions' with a broad range of stakeholders and their advisers' and says 'significant progress has been made'
- This morning the group has made a third set of proposals saying 'the board is now in a position to set out modified restructuring proposals'

The Major Modification:

- Punch Taverns says that 'the modified restructuring proposals reflect a number of structural changes requested by senior and junior bondholders' that include:
  - Punch A will be deleveraged at completion.
  - There will be less 'cash leakage' to other stakeholders with some 54% less cash leaking out over a three year period
  - Senior notes will be repaid 'to a fixed amortisation schedule'
  - Junior bondholders will receive cash and 'new LIBOR-based cash pay and PIK notes'

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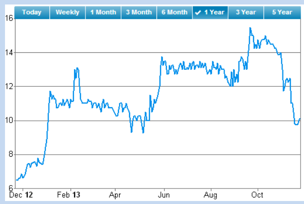

Market Cap: £72m
12m range 6.5p 15.5p

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- The above goes some way to addressing the concerns of the senior bondholders – but the $64k question is will the new proposals go far enough?

Where We Stand Now:

- Punch Taverns' board, which has put together today's proposals, is clearly of the opinion that they are workable. It says the proposals:
    - Create 'a more robust & sustainable debt structure'
    - They also preserve the benefits of the group structure (rather than incur the costs and dis-synergies of an enforced break up and administration
    - The proposals should reduce the debt to EBITDA multiple within the securitisations by 400bps more than would be the case without a restructuring
- The senior bondholders, represented by the ABI and Rothschild, have not agreed to the above proposals and, in Round I and II, they commented (negatively) in the immediate wake of the proposals being made public
- Punch says 'there remain different and conflicting views from some stakeholders on certain aspects of the proposals'

Where To From Here?

- The various parties have been talking for two years and Punch Taverns will formally launch these 'final proposals' by 15 January 2014
- After the requisite notice period, bondholders will then be asked to vote on the proposals and the senior bondholders will at that point, if they have not been able to wring further concessions in the next five weeks, have to agree or not
- In the latter case, the management will have to decide whether the company can continue in its current form

Conclusion:

- At some point the talking had to stop
- The bondholders can now agree or decline to do so
- The latter would put the ball back in the Board's court as it would have to decide whether or not at that point to call in administrators
- The outcome is still binary. The downside (for equity) is 100% whilst the upside could be materially more

Langton Comment: Punch Taverns' shares provide something of an option over two very large but out of the money securitisations.

As will all options, the value of the instrument could fall to zero but it cannot go below that level.

The potential upside is significant. There does not appear to be any talk of warrants or equity dilution here. Equity is tiny in comparison to the two largest numbers on the balance sheet (fixed assets and debt) and material movements in either of those figures could wither wipe shareholders out or see them make very material returns – albeit at significant risk.

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There is no further update on the group's trading here but, on 27 November, it was trading in line with expectations and LfL income was in positive territory across core pubs.

Net assets, however, are only £295m, meaning that the group's share price is very sensitive to movements in the value of debt (some of which would be redeemed at a discount under the current proposals) and property prices (which may have stopped or at least slowed going down).

One should reiterate that an investment in the group's equity is very risky. An agreement with bond holders might not be possible, in which case the company is likely to move into default on its securitisations at some point in the next 15 months or so but an agreement would yield very material returns.

Whilst value-destroying decisions are made on a depressingly frequent basis, the senior bondholders do not wish to lose their money, the group has always paid its interest and the restructuring game continues to be worth the candle.

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