15 Jan 14

PUNCH TAVERNS (PUB): 16.5p
Debt Restructuring Documentation Published

Punch launches proposed capital restructuring. Not yet agreed. Says proposals 'are final' and failure to agree will 'lead to default in the near term…'

Year to end-Aug	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2012 (A)	52.4	7.2	2.3	Nil	Nil
2013 (A)	17.0	5.7	2.9	Nil	Nil
2014 (E)	46.0	5.4	3.1	Nil	Nil

Source: *Company & Broker Estimates*

Proposed Debt Restructuring Documentation Published:

Punch Taverns has put outline restructuring proposals to its debt-holders on three separate occasions last year. The first two proposals, in February and in June, were rejected by Senior Bondholders who then, using somewhat more moderate language, declined to accept the proposals put forward in December.

Proposal(s) III featured less cash leakage, fixed amortisation schedules and the introduction of PIK notes for some junior bond holders. Punch at that point said that it would 'move forward to formally launching final proposals for each securitisation by 15 January. Note-holders will then be asked to vote on the restructuring proposals on 14 February, after the appropriate notice periods'.

The Documentation - Introduction:

- Punch has said that the document is the culmination of 14 months of work and 'the restructuring proposals are final'
- There have been some concessions since 9 December
- A failure to agree 'is expected to lead to default in the near term'

The Documentation – Main Terms:

- The proposals include:
    - Fixed amortisation schedules for senior notes and Spens protection thereon with 'strengthened covenants'
    - Increased PIK coupons for junior bond-holders
    - Senior note-holder Board observers (NEW*) and a voting fee of 0.10% for note-holders (also NEW* though note-holders had asked for 25bps)

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Market Cap: £106m
12m range 6.5p 16.5p

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- Group has said it will no longer commit PLC cash unless the proposals are agreed

The Documentation – PLC View:

- Punch says that 'the proposed terms…are in the best interests of all stakeholders and will deliver material benefits to them'
  - The deal would preserve synergy benefits, prevent a default and/or fire sale and allow the group to invest in its assets
  - Spirit and latterly Punch itself have been able to demonstrate the positive impact of freed up capital spending
- The restructuring 'will create a robust debt structure' and 'provide a solid platform to allow Punch to build on the recent improvement in the Group's trading…'
- Executive Chairman Stephen Billingham says that the group is open to answer questions but warns that a failure to agree 'will lead to a much worse outcome with considerable uncertainty for the business and potentially significant loss of value'

Where We Stand Now:

- The various note-holders now have until 14 February to vote their intentions
- They (and they are not a homogenous groups, to say the least), now have to decide whether to accept the proposals, to reject them or to abstain. In the case of a 'yes':
  - Considerable detail as to the outline of the proposals has been available for some time. This would suggest that note-holders could or should have made their minds up already
  - However, in the case of an acceptance, there is nothing to be gained by moving quickly.
  - Accepting note-holders may well wait until the last minute in order to keep their options open and/or lobby for further concessions
- And in the case of a 'no' vote? This would be sub-optimal. The group has raised the stakes by saying the terms are final. It is possible, however, that a 'no' vote would not terminal unless the management carry through the suggestion that they can do no more and call in administrators.
  - A negative vote, however, could come quickly as, even if a non-assenting bond-holder is only mildly negative re the terms of the deal, it doesn't hurt to say 'no' early on as it could improve one's bargaining position
  - One 'no' vote could/would scupper the deal as it stands and, if a note-holder knows that another is going to vote (or has voted) 'no', then it is to their advantage to say that they were going to do so as well
  - Hence a negative outcome could become apparent soon and could snowball into a flurry of competitively negative noise when none of the individual bond-holders actually thought the deal was a particularly bad one in the first place
  - This would not be the optimal outcome. Not by a long way. What happened thereafter would depend on whether 'final' meant final.

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    - This is somewhat unclear and the least that would happen is that there would be a period of material uncertainty followed during which there may be resignations or even more unpleasant developments

- What is the more likely outcome?
    - Well we wish we knew. The ABI responded negatively to the 9 December proposal but the language was perhaps somewhat less fiery than might have been anticipated
    - It may be more difficult for the ABI to respond today or tomorrow following the group's use of the word 'final'
    - The ABI said that it believed that the terms were 'moving in the right direction' and that a consensual agreement was the 'best way forward for all parties'
    - The ABI went on to say in December that 'such an agreement is capable of being reached and (is) within the gift of the shareholders of Punch'
    - The senior bonds want perfect security, maybe higher coupons, guaranteed repayment, board representation and a 25bp fee for compliance – but they won't get any of this by busting the company
    - Equity still has some influence (to say the least) as Punch has never not paid its interest let alone actually gone into default

The Possible Outcomes:

- If the proposals are accepted:
    - This would not be clear until the vote.
    - The impact on equity would depend upon any degree of dilution.
        - The words 'dilution', 'option' or 'warrant' do not appear in the statement.
        - A much longer document is clearly to follow.
        - The PIKs could carry warrants but there is no mention of this in the document.
    - A higher coupon on a lower absolute level of debt would be modest earnings enhancing.
    - These numbers are illustrative only but, more importantly, debt levels would fall, repayment schedules would be pushed out and the NAV per share would increase (to perhaps around 90p, ex-intangibles)
    - Punch could, for the first time in many years, be valued on an earnings basis and, with virtually unchanged EPS of around 5.5p possible, a relatively modest PER of 8x would suggest a short term target price of perhaps 45p
    - With the group's core estate now back in growth and its non-core units declining 'by less than 5%', the geared nature of the company could see EPS rise at about 4x to 5x the rate of EBITDA increase with the latter rising at perhaps 2% per annum
    - Modest capital spending should enhance earnings further, 7p might be achievable in the short term and a more upbeat PER of 10x would imply 70p

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- If the proposals are rejected:
    - Although they may have been talking behind the scenes and the parties should have had time to settle their differences, this could happen relatively rapidly.
    - The use of the word 'final' clearly raises the stakes
    - However, both sides have to this point appeared to consider the game worth the candle and new proposals could be formatted by, say, Easter. This is less likely given today's 1) concessions and 2) wording

Langton Comment: The proposed deal is indeed the culmination of 14 months of work.

The talking has had to stop and these are the 'final' terms. Bondholders, once they have seen the full documentation, must now decide by 14 February whether they can support the deal.

The language and terminology does suggest that 1) concessions have been made – board observers and a 10bp fee for voting (yes or no) but that 2) this is meant to be the end game rather than a further negating ploy.

Some other considerations are unchanged. Punch Taverns' shares are extremely risky but they provide something of an option over two very large but out of the money securitisations.

As with all options, the value could fall to zero but the potential upside is significant. 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.

Whether warrants are created (and if they are, then in what quantity) will influence the value of Punch's equity going forward but survival should surely bring a reward of some sort and the warrants attached to Thomas Cook's equity when the banks extended facilities in 2011 and 2012 did not prevent the equity rising by more than 15-fold.

There is no certainty whatsoever that Punch's shares will react as well to what is a more complicated restructuring but there remains considerable potential upside, albeit at considerable very real risk.

Whilst value-destroying decisions are made on a depressingly frequent basis, the future of Punch is now in the hands of its senior bondholders. They have said that they believe a consensual deal is possible and the indications, thus far, have been that they believe the restructuring game continues to be worth the candle.

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