Langton Capital Limited

11 Feb 2014

PUNCH TAVERNS (PUB): 13p
ABI (and others) Reject Proposals

The coming days are 'amongst the most important in the company's history…'

Year to end-Aug	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2012 (A)	52.4	7.2	2.1	Nil	Nil
2013 (A)	17.0	5.7	2.6	Nil	Nil
2014 (E)	46.0	5.4	2.8	Nil	Nil

Source: *Company & Broker Estimates*

Proposed Debt Restructuring: Friday Vote Nears:

The company has said that Friday's vote will go ahead. A number of bond-holders have said that they will vote against. There is no obvious Plan B. We consider the current state of affairs below:

Friday Vote: Positions becoming entrenched…

- **The state of play:** The company has reiterated that Friday's restructuring vote will go ahead and four groups of bondholders have said that they will vote against.
    - The company has said that it will at that point cease supporting the securitisations (Punch A soaked up a net £10m of support in FY13 and Punch B required £15m), the latter will then (either in early March or on a subsequent covenant test date) breach covenants and administrators may be appointed.
- **Is anyone bluffing?** Reality has been suspended and it is possible that, in the current pressure-cooker environment, the normal rules governing corporate and stakeholder behavior may not apply. Parties may be bluffing.
    - They may not even know they are bluffing and the difference between a bluff and an eleventh hour change of mind will be hard to disaggregate so never say never.
- **On the balance of probabilities:** On the other hand, neither side has shown the least inclination to back down, it's somewhat hard to see just how a compromise can be forged and 14 February will arrive on schedule whether or not any agreement has been reached.

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: £78m
12m range 6.5p 16.5p

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

- This maybe suggests that the most likely outcome is a failed proposal with administration of the securitisations perhaps to follow.

- **So what then?** The more assumptions that are made, the more likely some of them are to be wrong meaning that to speculate on Punch's past Friday is difficult to say the least.

  - However, in the short term, the PLC would save on the £23m or so that it would be required to contribute to its securitisations to prevent default and, if one or more administrations were to happen in March, this would not necessarily (or even likely) bring the PLC down.

- **More on life post administration:** In fact the PLC looks to be solvent. Punch Taverns PGE, which is where most of the non-securitised assets lie, has subsidiaries Punch Taverns Offices, Punch Taverns PGRP, Punch Taverns Finco (which holds half of Matthew Clark) and PT Services which between them hold around (at year end) £58m of cash, 50% of Matthew Clark (which contributed £4.8m post tax and which could be worth £40m to £50m) and about 65 pubs (with a heavy mix of leasehold units but said to be worth around £10m at the group's last year end).

  - Valuation of PLC: Taking the above undiluted suggests around £116m or some 17p per share. This could have been eroded by any payments to the securitization since August and by the costs of the debt proposals to date.

  - This may pull the amount down to below £100m or some 15p a share and there would be other costs. Add in the time value of money and PLC could be worth 10p or 11p.

  - More on the valuation of PLC: Hence, if equity had to wind everything up and walk away, the 10p would not be optimal but nor would it be nothing. And the group has options.

  - The £100m or so in PLC could, if the group wanted, support the securitisations for some time to come and trading is improving but it is arguably the tax losses that could be interesting.

- **The valuation of PLC's tax losses:** It is not obvious from Punch PLC's report and accounts where the losses lie.

  - The group says (note 17, p64) that it had (at August 2013) some £34m of trading losses and £1,714m of capital losses being carried forward.

  - Both sets of losses are redeemable at the group's marginal rate of corporation tax (20%) but capital losses are redeemable only against capital profits).

  - It said its trading losses had been provided for as a deferred tax asset but that some £1,716m of (mostly capital) losses were not shown as an asset anywhere in its books and it reminded us that 'current legislation deems that these losses may be carried forward for an unlimited number of years'.

- **More on tax losses:** Securitisations are a relatively new phenomena. It could be that the losses are in the two securitisations (Punch Parnerships PML and Punch Parnerships PTL) but this would not be 'normal' (to the extent that there is a 'normal') but these groups only have negative Profit & Loss Reserves of around £700m between them suggesting that most or all of the tax losses are held in the non-securitised companies, where there are

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

accumulated losses for balance sheet purposes of more than £2.7bn in PT Finco and PT PGE alone.

- **Conclusion on tax losses:** To take this further you would find 1) access to the PLC to discuss the issues and 2) the help of a tax accountant very useful and we do not currently have access to either.
    - A key question would be, for example, if a company such as Morrison's, which is about to make large capital gains via a sale and leaseback were to acquire one or more Punch subsidiary, would it be able to offset its gains against its new subsidiary's prior losses?
    - Conclusion on tax: Good question, no answer at present. If Punch's un-provided losses of £1,716m were ever redeemed at 20% they would be worth £350m or around £343m or 52p per share.
    - This would have to be split with an acquiring company but should be worth something. The PLC will be well-aware of its own position and this could have an influence on its negotiating stance with bondholders in the run up to Friday's vote.
- **Conclusion on Punch Taverns:** Executive Chairman Stephen Billingham says 'the next few days will be some of the most important in the Company's history' and it is hard to disagree with him.
    - He says 'the Punch Board calls on all parties to vote in favour of the Restructuring proposals' and maintains that, after 14m of effort, these are the proposals that both disappoint the least number of stakeholders.
    - He says the company has 'tried to listen to everyone and find a middle way' and, if the PLC has 17p of assets and 53p of tax losses behind it, he may not be bluffing.
- **Punch – don't forget the trading:** Punch's performance on the ground is improving and Billingham points out that 'just as Punch's operational performance is turning the corner, the last thing the business needs is for continued uncertainty.'
    - This is true and, though many bad decisions are made by accident, the game would appear to be worth the candle. It is possible that one, very large bad decision could be made because individual bondholders make micro-bad decisions and the outcome will be what it will be.
- **Punch, a glimpse into the future:** The recent denial that Punch had sanctioned buying out of the tie is one illustration of how the wheels could come off the securitisations should they go into administration and a deal whereby the senior bondholders get all of their money back (they were never entitled to more) and juniors see some diminution of value albeit perhaps not from the prices that they actually paid, should be the best outcome.
- **Punch and its tenants:** Separately, Punch has said that it would be unable to 'guarantee' the security deposits of its tenants should the securitisations go into administration as it would no longer be in control of the vehicles.
    - It has said that it would be extremely unlikely that an administrative receiver would not protect the funds.

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

- The depositors would be treated in line with other creditors and there are enough funds to repay them – but not if bondholders were to demand back 'all' of their cash overnight.

Langton Comment: So we have here something of a problem. Bondholders may vote against but it is not clear if they have fully thought through the consequences. Neither securitisation has the structure to look after 4,000 pubs and, though some sort of transition services deal could perhaps be struck with one of the other operators in the UK (or even with Punch PLC), it is likely that this would not be seamless and there would be material value leakage across the estate(s).

And the situation is not made any easier by the fact that these securitisations were not meant to be easily unpicked. They had coupon uplifts built in, etc. which were intended to encourage re-financing but the unwinding of the whole thing was only meant to happen much further down the line.

And ego may now be involved. The group's two largest equity holders, Glenview and Luxor, are sitting on large equity losses and will be keen to redeem some of this if possible. And there have been hints (in the Telegraph) that the two US hedge funds have blocking stakes in bonds themselves suggesting that they are in a position to block further progress even if the securitisation go into administration.

Furthermore, bondholders, via the Daily Telegraph, seem to be saying that an administration of one or both of the securitisations will make little difference to the businesses as a whole but maybe they've been spending too long in front of a spreadsheet in EC2 rather than wandering into and around pubs in HU8, YO10 or whatever.

Because what happened in your classroom when the teacher left? In fact, what happened when they didn't just pop to the loo or sneak out to send a surreptitious text but when they threw the keys on the floor, leapt into their car and disappeared for the rest of the day?

Buying out may be one of the first things to happen. Publicans, bless them, will also probably be keen to test the resolve of their BDMs, they may be slow with their rent (on the basis that the company has a rent deposit and they'd like to secure that ASAP) and they may generally push in areas that they have not pushed before.

And who would run the pubs? Do the securitisations have their own staffing systems, head offices, payroll systems and the like or would the staff directly employed by them be left without wages and leaderless? Yes the securitisations have boards of directors but you can't run 4,000 pubs from a boardroom.

Overall we find ourselves once again quoting Mr Rumsfeld in that there's an awful lot we know we don't know. Come Friday, our ignorance will be diminished very slightly but the future, either in or outside of administration, is also less than clear. The best outcome for equity by a very long way would be a 'yes' vote but this perhaps seems to be odds against.

But there would appear to be a tenable future for equity if the securitisation(s) go into administration. It is not obvious that the company would or should suspend its shares and there is value in PLC. The cash, pubs and stake in Matthew Clark are obvious but the potential value of the tax losses is something of an unknown. This is a gamble and it is probably an 'un-investable' situation for most but, should the group trade through its current problems, it offers very material upside albeit at very considerable risk.

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

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

mark.brumby@langtoncapital.co.uk

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