Langton Capital Limited

08 September 2015

PUNCH TAVERNS (PUB): 125.88p
Q4 & 52w IMS to 22 August & Matthew Clark disposal

Group brings debt down further and is on course to report underlying EBITDA of between £193m and £200m for the year…

Year to end-Aug	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2014 (A)	50.8	n/a	n/a	Nil	Nil
2015 Est	57.2	21.1	4.9	Nil	Nil
2016 Est	59.6	21.4	4.8	Nil	Nil

Source: *Company & Broker Estimates*

Q4 Results & Matthew Clark Disposal:

Punch Taverns has released a trading statement for the 52 weeks to 22 August 2015 and has further updated on the sale of its 50% stake in Matthew Clark & our comments are set out below:

Headline numbers:

- The group expects to report underlying EBITDA of between £193m and £200m in its preliminary results on 12 November, at which time new CEO Duncan Garrood will update on the group's strategy.
- Disposal proceeds are ahead of guidance; the group's assets continue to look undervalued with shares trading at around 40% of book value.
- Punch has sold its 50% stake in Matthew Clark to Conviviality Retail for £100.7m in cash, almost twice the unaudited amount at which its stake was valued at on its balance sheet (£52.3m). A consideration of £1.5m will be paid to Punch Finco as a dividend.
- Punch Taverns is continuing to benefit from positive like-for-like trends in net income with core estate net income up 0.3% (post-disposals, Punch's core estate is expected to generate c95% of pub EBITDA in 2016). Recent trading details are set out below:
- **Tab.1. Punch Taverns LfL EBITDA Per Pub Trends:**

Period	LfL EBITDA/pub (tot. estate) (%)	LfL EBITDA/pub (core estate) %	LfL EBITDA/pub (non-core) %
FY 07/08	-3.4		
H1 08/09	-11.3		

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Market Cap: £286.26m
12m range 87p 189p

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FY 08/09	-11.0		
H1 09/10	-11.0		
FY 09/10	-11.0		
H1 10/11	-7.0		
FY 10/11	-5.2	-2.1	-13.0
H1 11/12		-2.1	
FY 11/12		-3.7	
Q1 12/13		-5.2	
Q2 12/13		-3.5	
Q4 12/13		+0.4	
FY 12/13		-2.4	
Q1 13/14		+1.4	
H1 13/14		+1.4	+0.4
Q3 13/14		+1.4	
FY 13/14		+1.3	
10w 14/15		+0.8	
H1 14/15		+0.5	
FY 14/15		+0.3	

Source: Company Reports

Trading:

- Non-core disposals have improved the quality of Punch's estate, with average profit per pub up 4%.
- Group EBITDA is expected to be between £193m and £200m (2014: £205m)

Strategy, development, restructuring etc.:

- Net debt has been reduced by a further £102m since its October 2014 financial restructuring to a total of £1.4bn (debt now 7.3x EBITDA v 9.5x in August 2014).
- The group has surpassed its H1 guidance on disposals (of 'up to £80m'), and says its 'disposal proceeds [are] ahead of guidance at £89m, above book value and at a multiple of 26 times EBITDA'.
- Disposals include the sale of 158 non-core sites to NewRiver Retail for £53.5m (£340,000 per pub), set to be completed by 11 September.
- The group said of its sale of Matthew Clark: 'We are pleased to have agreed the disposal of our investment in Matthew Clark and at a significant premium to our current book value… we will enter into a 10 year drinks supply agreement with Matthew Clark for the supply of wines and spirits into the Punch estate.'
- Punch's property estate is externally valued at £2.097bn. By contrast, its market capitalisation is £286.26m and its enterprise value is £1.74bn.
- Management will update on the group's strategy with regards to the Market Rent Only Act in November.

Conclusion:

- Punch remains the only company to our knowledge to have unpicked a complicated securitisation in the aftermath of the 2008-09 credit crunch. The group knocked off some £513m in the year to lower debt to £1.4bn.

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- Punch says ‘actions have already begun to provide a more flexible business model in light of the anticipated introduction of the Market Rent Only option (MRO) in 2016’. Its disposals programme is running smoothly and the market has been pricing its assets at a premium. More strategy regarding the MRO will be shared in November.

- Such strategies are likely to include managing units, potentially franchising some and generally taking more active control over some assets. The changes should be similar in nature to those announced by Enterprise Inns.

- Chief executive Duncan Garrood says ‘The business has ended the year with a solid set of results, in line with our expectations. The business has clear plans for further debt reduction and will benefit from being able to focus more resources on the higher quality core pub estate.’

- The new CEO adds ‘Since joining Punch on 15 June I am excited by the opportunities I see in the business. I look forward to updating the market on our plans when we present our full set of results on 12 November.’

Langton Comment: The uncertainty caused by the upcoming Market Rent Only option continues to weigh on Punch shares (125.88p) despite there being a good chance that, looking back to today a year from now, they might appear cheaply-priced.

Punch’s financial restructuring and capital management has seen some £0.5bn knocked off its debt pile in the financial year, bringing it down to c£1.4bn – less than half of the £3.26bn in 2010. An additional £100.7m has already been generated post-year end through the sale of its stake in Matthew Clark. By contrast, its property estate has been externally valued at just over £2bn.

The group’s disposals are fetching prices comfortably in excess of book valuation. Trading remains in line and Punch has confirmed its earlier guidance of underlying EBITDA of £193m-£200m. Although the upcoming MRO creates a lack of visibility for the group, rival Enterprise Inns has laid out a template for dealing with the changing industry landscape.

We are of the view that around 21p (1.05p in the old form) should be achievable and, though there may be further forecast changes as the impact of the MRO becomes clearer, this represents something upon which the company should be able to build. In the meantime, investors may feel placated by the group’s steady trading, ongoing non-core disposals and debt reduction, and its discount to book value.

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