



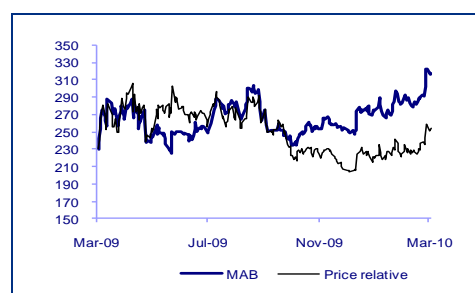
STRATEGIC ACCELERATION

MAB's recently announced strategy confirms large parts of the previous strategic update given in January – but clearly accelerates the process. This should be good news for both the business and its shareholders and, in our view, confirms MAB's position as the best 'quality' investment in the 'pub' sector. Factoring in only 50% (£25m) of the expected profit uplift from this new strategy still allows us to increase our target price to 426p from 365p.

- MAB's strategic review cost nothing but should yield substantial returns. The company plans to focus a lot more on its food-led outlets, and at the same time reduce its exposure to small wet-led concepts. From a big picture perspective, given the trends towards eating out and particularly towards 'value' concepts, this is clearly the right strategy – but it crucially depends on good execution, and in particular the company's ability to find good sites on High Streets and in leisure/retail parks to develop the new food led units.
- The company expects that around 15% (300 units) of its current estate of 1,900 sites are not likely to 'fit' the business going forward. These 300 sites are likely to be replaced with 300 new sites (both freehold and leasehold) over the next three years. This churning of the estate will be one of the key measures of success (or otherwise) for the business going forward.
- The other key result from the review is the expected improvement in operating margins, by 2-3% pts over the next three years – from the 15.3% reported in FY09, through better purchasing, menu engineering and some selective price increases. We had already anticipated a 1% pt improvement over this period and under our new central case scenario we have increased this to a 2.5% margin uplift. This, together with the benefits from churning 300 of its pubs and converting 100 others, could lead to an increase in full year EBIT of £56m by 2012, which would result in an increase in PBT of £51m (+27%) to £242m.
- However, given uncertainties over timing and the execution risk, we have only factored 50% of this EBIT uplift into our current estimates. In addition, taking into account of the part year impact of churning, our overall upgrade to PBT in 2011 is £7m (+4.2%) to £180m, and for 2012 it is £18m (+9.3%) to £209m. Clearly the risk to these figures should be on the upside.
- We also believe it is reasonable to bring forward our estimate of when MAB will recommence dividend payments – to H2'10 from H1'11. Consequently, we now (for the first time) anticipate a final dividend for the current year of 6.5p.
- Using our discrete EVA-based valuation approach, we derive a 'fair value' in 2012 of 567p. Discounting this back by 10% pa, our new 12m TP is 426p (previously 365p). If we were to factor-in the full potential EBIT uplift of £56m in 2012 (instead of £25m) then our TP would be 503p. We remain buyers.

Rating	BUY
Target price (p)	426
Current price (p)	314
Upside/downside (%)	35.7%
Main listing index	FTSE 250
Reuters/Bloomberg	MAB.L / MAB/ LN
Sector	Travel & Leisure
Shares in issue (m)	407.7
Market cap (£m)	1281.4
Current EV (£m)	3973.2
Current (debt)/cash (£m)	-2600.0
Free float (%)	52.5%
52 wk range (p)	323 – 225
Next event: H1 results	19 th May'10

Year-end Sept (£m)	2009	2010E	2011E
Revenue	1958	1996	2026
EBITDA	428	448	468
EBITA	300	317	336
PBT	134	158	180
Net (debt)/cash	-2600	-2422	-2377
Net pen. def (IAS19)	-94	-94	-94
Net assets/(def)	997	1103	1185
EPS (p)	23.6	27.6	31.4
DPS (p)	0.0	6.5	10.5
FCF (p)	55.4	47.1	45.3
P/E (x)	13.3	11.4	10.0
EV/EBITDA (x)	9.3	8.5	8.0
FCF yield (%)	17.6%	15.0%	14.4%
Div yield (%)	0.0%	2.1%	3.3%
Div cover (%)	n/a	n/a	3.0
Net debt:EBITDA (x)	6.1	5.4	5.1
Interest cover (x)	1.8	2.0	2.2
Fixed CC (x)	2.2	2.4	2.5
ROIC (%)	5.7%	6.2%	6.6%



Research

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STRATEGIC REVIEW

The recently completed strategic review was started by the new Chairman (John Lovering) following his appointment at the AGM in January 2010. The main conclusions from the review were as follows:

MAB will reshape the business to focus more on its food-led brands – which it correctly, in our view, believes have better growth prospects. There are currently about 900 units in the six brands that it wants to develop. Ultimately it believes that these could potentially reach 1,900 units at maturity. Of these, about 300 to 400 units will be leasehold – whereas at the moment they are mainly freehold. We have not assumed that the company does any sale & lease backs of its existing sites, although this is of course a possibility.

It will dispose of its wet-led price sensitive drinks concepts. Over the next three years this will probably involve the disposal of about 300 units. The capital will be redeployed into the development its food-led concepts. We have assumed that 300 new units are added over the next three years, of which 150 are leasehold and 150 are freehold.

The company also expects to improve its operating margins by between 2% and 3% pts over the next three years, compared with its FY 09 reported margin of 15.3%. This is from better buying, menu engineering and selective price increases. It will also look to lower central costs from the current run rate of 4.3% of sales (circa £86m) to 3.75% of sales by 2014. This central cost reduction is included in the overall margin increase mentioned earlier.

The company will also be looking to invest its capital more effectively, and in particular improve the efficiency of its capex and reduce its working capital (by £10m).

The company is also looking to continue paying down its debt to around 5x net debt:EBITDA – which on our numbers it should reach in its next financial year.

Before considering the potential financial consequences from implementing the new strategy, we first review the proposed product offering and its market position.

At its first strategy update in January, the company split its estate into the three categories – ‘maintain’ formats, ‘selective’ brands and ‘active’ brands. The number of units in each area is shown in the table below. We have then adjusted these numbers to reflect what we believe the company will be looking to add (or reduce) in each area based on the information disclosed in its more recent strategy update.

Figure 1: Current Estate Profile With Prospect Changes

	Maintain brands	Selective brands	Active brands	Total
No. of sites	608	309	897	1,814
(Disp)/acq	-308		300	-8
Conversions	-100		100	0
Total in 3 years	200	309	1,297	1,806
Further expansion		41	603	644
Potential total	200	350	1,900	2450

Source: Company data; Matrix estimates

Note: The Active brands (ie growth brands) are Vintage Inns, Premium Country Dining, Harvester, Toby Carvery, Crown Carveries and Sizzling Pub Company. The Selective formats/brands are Browns, Miller & Carter, Metro Professionals, All Bar One, Nicholson's and O'Neill's. Finally, the 'Maintain' formats/brands are Bars & Venues, Ember Inns, Community pubs, Town pubs, Scream and Hollywood Bowl.

We believe that the most likely 'maintain' brand that will remain is Ember Inns, of which there are over 200.

Figure 2: Expected Expansion of its Main 'Active' Brands

Main 'active' brands	Current no. (units)	Expansion (units)	Expansion (%)	Potential no. (units)
Harvester	171	229	134%	400
Toby Carvery	133	167	126%	300
Crown Carveries	111	189	170%	300
Sizzling Pub Co.	200	200	100%	400
Premium country Dining	61	89	146%	150
Vintage Inns	237	113	48%	350
	913	987	108%	1,900

Source: Company data; Matrix estimates

The expansion of these main brands is, going to be focused towards retail parks, leisure parks and High Streets. At the time of its January strategy update, the company stated that there were 180 leisure parks that did not have a Harvester (and only 25 that did). Restaurant Group have about 300 restaurants that are in either leisure parks or retail parks, and has plans to open a further 17 to 20 pa for the next couple of years and then (we estimate) 30+ pa thereafter.

Given that there over 1,000 leisure/retail parks in the UK, this would seem to indicate that there should be more than enough sites for MAB to expand its estate into.

The main question, in our view, is not so much the room for expansion, but rather whether the brands are going to be competitive/successful in these new locations alongside the higher priced brands such as Frankie & Benny's or Chiquito's, or indeed whether smaller variants are going to be successful in the High Streets. Obviously, at this stage it is difficult to be certain of the degree of success of these brands, but given the provenance of these brands and MAB's experience and systems, we would suspect that they are more likely than not to be successful. In any event, MAB has indicated that before any roll-out the brands will be thoroughly tested and trialled first to reduce the risk of failure.

To put the expansion into perspective, the total UK eating out market is estimated to be worth about £37bn (exc. VAT), of which the pub market accounts for between £7bn to £8bn. MAB accounts for about £0.8bn of this food spend at the moment and this would be expected to increase to nearer £1.0bn (out of its total revenues of about £2.0bn) by 2012. By the time the main brands have reached 1,900 food-led units, we would expect its food mix to be nearer 60%+.

Financial Impact of New Strategy

In the table below we have summarised the impact from the company's new operating margin target of improving margins by 2% to 3% over the next three years

Figure 3: Impact From Margin Improvement

Y/E September	2009	2010E	2011E	2012E
'Old' Revenue	1957	1996	2026	2057
'Old' EBIT	300	317	326	337
Old EBIT margin (1% uplift by 2012)	15.3%	16.0%	16.2%	16.3%
Cautious case (1% uplift)				
EBIT after new strategy with further 1% margin uplift	300	317	336	357
New EBIT margin assuming further 1% uplift	15.3%	16.0%	16.6%	17.3%
Central case (1.5% uplift)				
EBIT assuming a further 1.5% margin uplift	300	317	341	367
New EBIT margin assuming with further 1.5% uplift	15.3%	15.9%	16.8%	17.8%
Bullish case (2% uplift)				
EBIT after new strategy with further 2% margin uplift	300	317	346	377
New EBIT margin assuming with further 2% uplift	15.3%	15.9%	17.1%	18.3%

Source: Company data; Matrix estimates

In the table below we have estimated the impact from selling 300 'maintenance' format sites and acquiring 300 'active' brand units. We have further assumed that of the 300 new units, half are freehold sites and half are leasehold sites. We have assumed that the company spends £2m per freehold site on which it generates an EBIT return of about 12% (or an EBITDA return of 15%) in year 2. We have also assumed that MAB spends about £1m per leasehold site on which it should generate an EBITDAR return of 25%. We have assumed that it will pay a rental yield of about 7%, leaving EBIT returns of about 17%. After deducting EBIT of £125K per site for the 300 sites that MAB is going to sell, we calculate that MAB should generate about £22m of extra EBIT in a full year 2. However, after adjusting for the timing of part year acquisitions and disposals, we estimate that the actual year 2 enhancement would be nearer £16.5m.

Figure 4: Impact From Churning 300 Sites

Y/E September	2009	2010E	2011E	2012E
EBIT lost from 300 disposals				-38
EBIT gained from 150 new leasehold units				25
EBIT gained from 150 new freehold units				35
Full year Net EBIT impact			11	22
Adj for part year			-5.5	-5.5
Actual EBIT impact			5.5	16.5

Source: Company data; Matrix estimates

The table below summarises our thoughts on the financial impact from MAB converting 100 of its existing 'maintenance' format sites and converting them to 'active' brands. We have assumed that the company converts 50 units pa at a cost of £300K per site, and achieves an EBIT return of 20%. We have also assumed that each conversion takes about three months to complete and thus 'disrupts' profits by about £2m pa during this process.

Impact from converting 100 sites to 'active' brands

Figure 5: Impact From Converting 100 Sites From 'Maintenance' To 'Active' Brands

Y/E September	2009	2010E	2011E	2012E
Current EBIT		12	12	13
Estimated returns from investment @ 20%		0	3	6
EBIT disrupted			-2	-2
Full year EBIT impact		12	14	17
Adj for part year impact			-2	-2
Actual EBIT impact			12	16

Source: Matrix estimates

Adding all of these three pieces of the strategy together (ie, the uplift in operating margins, the churning of 300 units and the conversion of 100 sites) we summarise the total impact on group EBIT in the table below.

Figure 6: Summary of EBIT Impact From New Strategy

Y/E September	2009	2010E	2011E	2012E
Current EBIT estimates	300	317	326	337
New EBIT estimates				
Cautious case	300	317	341	376
Central case	300	317	346	386
Bullish case	300	317	351	396
Incremental EBIT based on central case	n/a	0	20	49
Actual EBIT enhancement			6.3%	14.7%
Full year enhancement			8.4%	16.7%
New EBIT 'central' case - no adj.	300	317	346	386
Actual new EBIT after applying 50% of uplift		317	336	362

Source: Matrix estimates

What we have shown above is that on a 'central' case basis, EBIT in 2012 can be upgraded to £386m from our previous estimate of £337m, if we apply no discount factor for execution risk. If we were to also disregard the impact of part year timing, the EBIT enhancement would be improved by a further 2% (from 14.7% to 16.7%).

However, we have for the time being decided to discount the EBIT enhancement by 50% to take account of execution risk (more to do with timing than anything else) and consequently what we have actually included in our official estimates and target price calculation is an EBIT of £336m in 2011 and £362m in 2012.

This then flows through to our PBT as shown in the table below. Because we have decided to bring forward our assumed start date for dividend payments from H1 11 to H2 10, we have split the impact on its interest charge between that driven by the impact of the new strategy (and in particular the increase in net capex) and that driven by the resumption of dividend payments – an extra £27m cash outflow in FY 11.

On a full EBIT basis, we estimate that the implementation of the new strategy should enhance PBT by about 26% (ignoring any timing phasing). However, on our more conservative basis of assuming only 50% of the EBIT enhancement flows through to profits, and after taking account of the extra interest associated with the early (assumed) resumption of dividend payments, the PBT enhancement is a more modest 10%.

Figure 7: Summary PBT Impact

Y/E September	2009	2010E	2011E	2012E
Current PBT estimate	134	158	173	191
Incremental EBIT (central case)	n/a	0	20	49
Interest impact (ignoring extra divi)		0	-2	-5
PBT enhancement		0	18	44
			10.7%	23.3%
Full year PBT enhancement				25.9%
Applying 50% EBIT discount				
New PBT after applying 50% of EBIT uplift	134	158	181	211
Interest impact for div			-1	-2
Actual new PBT estimates	134	158	180	209
Increase in PBT from old forecast	0.0%	0.0%	4.2%	9.3%

Source: Matrix estimates

At this point our analysis does not include the additional benefits of MAB increasing its estate after 2012. In our assumptions, at that time, MAB's estate will still be about 1,900 units, but the company has plans to roll out the 'active' brands to nearer 1,900 units on its own. This would increase the size of the overall estate to nearer 2,400. We estimate that this could enhance PBT by between £30m (conservative case) to nearly £60m. If we take a mid-point enhancement of £45m, this would represent about 20% enhancement to our current 2012 PBT of £209m. Clearly we do not know how long this expansion will actually take, but it will make a pleasant change to think that MAB's estate will have a growth prospects on an ongoing basis.

The financial effects of the new strategy covering the period up to, but not beyond, 2012, flow through to our P&L and Cash Flow as shown below.

Figure 8: Profit & Loss – MAB

Year-end Sept (£m)	2007	2008	2009	2010E	2011E	2012E
Revenues						
Pubs & bars	968	954	958			
Restaurants	908	939	999			
Total retail revenue	1876	1893	1957	1996	2026	2057
SCPD	18	15	1	0	0	0
Total revenue	1894	1908	1958	1996	2026	2057
EBITDA	472	477	428	448	468	495
<i>Margin</i>	25.2%	25.2%	21.9%	22.4%	23.1%	24.1%
EBIT						
Pubs and bars	191	176	159			
<i>Margin</i>	19.7%	18.4%	16.6%			
Restaurants	145	156	141			
<i>Margin</i>	16.0%	16.6%	14.1%			
Retail EBIT	336	332	300	317	336	362
<i>Margin</i>	17.9%	17.5%	15.3%	15.9%	16.6%	17.6%
SCPD	7	11	0	0	0	0
Total EBIT	343	343	300	317	336	362
Net interest payable	-147	-167	-166	-159	-156	-153
Interest cover	2.3	2.1	1.8	2.0	2.2	2.4
Clean PBT	196	176	134	158	180	209
Pension int inc / (cost)	11	3	-6	-6	-6	-6
Other exceptionals	-255	-417	-138	0	0	0
Reported PBT	-48	-238	-10	152	174	203
Clean tax	-59	-51	-38	-46	-52	-61
Clean tax rate	30.0%	29.0%	28.4%	29.0%	29.0%	29.0%
Exceptional tax credit	34	113	52	0	0	0
Total taxation	-25	62	14	-46	-52	-61
Clean net profit	137	125	96	112	128	148
Shares in issue (£m)	404	404	408	408	408	408
Avg. shares for EPS (£m)	408	403	406	408	408	408
Clean basic EPS	33.6	31.0	23.6	27.6	31.4	36.4
Dividend per share (p)	14.3	4.6	0.0	6.5	10.5	11.0
Dividend cover (x)	2.4	6.8	n/a	n/a	3.0	3.3

Source: Company data; Matrix estimates

Figure 9: Cash Flow – MAB

Year-end Sept (£m)	2007	2008	2009	2010E	2011E	2012E
Operating profit	343	343	300	317	336	362
Depreciation & amortisation	129	134	128	131	132	134
EBITDA	472	477	428	448	468	495
Movement in working capital	10	31	25	25	25	25
Movement in provisions	-2	0	-1	0	0	0
Costs of share remuneration	8	4	3	3	3	3
Regular pension cost less cash cont.	3	-2	-5	0	0	0
Additional pension contribution	-40	-24	-24	-24	-24	-24
Underlying cash flow from operations	451	486	426	452	472	499
Other/exceptional costs	-4	-15	0	0	0	0
Total operating cash flow	447	471	426	452	472	499
Net interest (paid)/received	-145	-164	-160	-156	-153	-150
Other financing costs	0	0	4	0	0	0
Tax paid	-33	-4	21	-8	-36	-52
Maintenance capex	-122	-111	-86	-120	-122	-125
Clean free cash flow	151	207	205	168	160	172
Reported free cash flow	147	192	205	168	160	172
Dividends paid	-52	-58	0	0	-41	-43
	95	134	205	168	120	130
Growth capex	-131	-82	-43	-20	-225	-225
Disposal of fixed assets	162	82	72	30	150	150
Acquisitions of Subsidiaries/ Assocs	-8	0	0	0	0	0
Issue of Ordinary shares	0	0	4	0	0	0
Share buy back	-46	-5	0	0	0	0
Proceeds on release of shares	11	3	0	0	0	0
Special dividend	-486	0	0	0	0	0
Forex & Other	-9	-388	-103	0	0	0
(Inc)/dec in net (debt)/cash	-412	-256	135	178	45	55
Net (debt)/cash at start of period	-2,067	-2,479	-2,735	-2,600	-2,422	-2,377
Net (debt)/cash at year end	-2,479	-2,735	-2,600	-2,422	-2,377	-2,322
Net debt :EBITDA	5.3	5.7	6.1	5.4	5.1	4.7

Source: Company data; Matrix estimates

Change in Assumptions on Dividends

Given the improving outlook on profitability for the company, together with the reduction in the company's bank debt, which we estimate will be about £250m by Sept'10 (and remain at that level for the following couple of years), we believe the company could and should pay a final dividend for the current financial year of 6.5p per share. The only caveat to this position is it presupposes that the company has successfully renewed its unsecured bank facility before it reports its FY'10 results. This should not be a problem given the overall level of debt to EBITDA should have declined to about 5.4x and be en route to 5.1x for FY'11. In any event MAB's current bank debt facility is due to mature in Nov'11 so we would anticipate it would look to renew its facilities about a year before then anyway.

Our earlier assumption over the recommencement of dividends (from H1'11 to H2'10) will have an additional cash cost of £27m in FY'11, which is included in our cash flow table above.

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