GREENE KING

LEISURE

GOOD BEER, GOOD PUBS, GOOD VALUE

The near 10% under-performance in GNK's share price since its last update on 28 April, in our view, presents a good buying opportunity. We see upside risk to both our estimates and consensus. We have always been keen on the fundamental qualities of the company, but now there is also an attractive valuation to make a compelling BUY case.

- The market has been extremely nervous for the prospects of the pub sector since the end of April, such that despite the gloomy backdrop resulting from the sovereign debt crisis, volcanic activity and the BP oil spill, the sector has still managed to under-perform the market by about 6.5% over this 6-week period. The under-performance has been quite widespread across the pub sector, with PUB being the worst (-30% rel.), followed by JDW (-14%), and then GNK and ETI (both -9.5%). To complete the picture, MARS' performance has been 'flat' relative to the market and MAB has marginally outperformed by 1%.
- While this under-performance, given current circumstances, is perhaps understandable for the highly leveraged companies such as PUB and ETI, and for the stocks that have disappointed in terms of trading updates (eg JDW's Q3 update), we do not believe it is justifiable for GNK.
- GNK's trading update on 28 April highlighted strong LFL performance from its managed estate of +3.6% (48% of profit) and an even stronger performance from Belhaven's managed estate of +5.6% (15% of profit). Even its tenanted estate had seen a sharp improvement to 'flat' profits in H2.
- While this did not result in upgrades to our ongoing estimates, it is likely to prove to be one of the better sets of statistics across the sector when the company reports its results on 1 July.
- We would also anticipate that the reasonable weather during May and early June should enable the company to report current trading LFLs above consensus at the time of those results (even before any W/Cup benefit) – and most probably a lot better than our current assumption of +1% for FY 2011.
- With a dividend yield of 5.6% for FY 2011 that is over 2x covered, we believe the stock is going to be seen as increasingly attractive in a market where yield is becoming more sought after.
- Moreover, we believe that as time goes on the company will find more and more attractive pub acquisition opportunities to utilise the cash raised from last year's rights issue.
- Finally, as a result of our time horizon moving forward, we are upgrading our TP from 471p to 480p and our recommendation from HOLD to BUY. It should be noted that our 'EVA based' target price is calculated after applying our normal 10% 'pub sector' discount.

Rating	BUY
Target price (p)	**480**
Current price (p)	385
Upside/downside (%)	24.7%
Main listing index	FTSE 250
Reuters/Bloomberg	GNK.L / GNK LN
Sector	Travel & Leisure
Shares in issue (m)	215.9
Market cap (£m)	831.2
Current EV (£m)	2250.0
Current (debt)/cash (£m)	-1350.8
Free float (%)	99.2%
52 wk range (p)	490 - 367
Next event: Final results	1st Jul'10

Year-end Apr (£m)	2009	2010E	2011E
Revenue	955	979	1017
EBITDA	267	265	271
EBITA	216	212	217
PBT	119	124	133
Net (debt)/cash	-585	-825	-825
Net pen. def (IAS19)	-70	-75	-75
Net assets/(def)	643	921	977
EPS (p)	53.4	44.1	46.2
DPS (p)	21.0	21.0	21.6
FCF (p)	93.4	52.3	56.0
P/E (x)	8.1	8.7	8.3
EV/EBITDA (x)	8.3	8.5	8.3
FCF yield (%)	21.5%	13.6%	14.6%
Dividend yield (%)	4.8%	5.5%	5.6%
Dividend cover (%)	2.5	2.1	2.1
Net debt:EBITDA (x)	5.8	5.1	4.9
Interest cover (x)	2.2	2.4	2.6
Fixed CC (x)	2.5	2.8	3.0
ROIC (%)	5.9%	5.7%	5.6%

Research

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MATRIX

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INVESTMENT BANKING

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Company	Disclosure
Greene King (GNK)	3

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