

Barry Voysey

From: Vanessa Macedo
Sent: 20 May 2011 11:20
To: Barry Voysey
Subject: M&C Report - UBS

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A leading analyst has said that with the catalysts of the smoking ban and the economic downturn he is surprised that more pubs have not permanently left the market.

In its latest report on the market, "Survival in a challenging industry", Jonathan Leinster at UBS, said: "After a jump with the new licensing regime in 2007, the number of on-trade licences has been very stable. This is surprising given the economic backdrop and the particular competitive pressures felt by pubs. We suspect the sector has not nearly rationalised enough.

"Consumer spending is under pressure, input costs are rising and long-term declines in beer consumption make for a continued difficult trading environment. Despite this, the pub industry is still struggling to reduce capacity. We therefore expect recovery to remain slow throughout this

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year.

"In the longer-term we believe there must be rationalisation of sites that cannot return their cost of capital. We expect that given the obstacles, supply will fall only very gradually."

Leinster said that leading operators will take share, but only over a long period of time.

He said: "Within that context, we believe that JDW, M&B, Greene King, and Marston's will take market share from under-invested managed pubs, financially over-stretched leased pub companies, and the freehouse trade in the longer-term.

"They have purchasing scale and for those that are not overstretched, access to capital. That means they can offer their customers a wider variety of food and drinks at good prices in a well furnished environment. A sole trader can still compete against a managed house, but they need to just be that much better a retailer.

"JDW, M&B, Greene King Retail, and Marston's Inns & Taverns should all take share from smaller pubs, and for now they are taking share from restaurant competitors. Their balance sheets are not overly stretched, their assets are generally well-invested, and they have scale advantages."

The report suggests that Enterprise Inns, Greene King Pub Partners, and Marston's Pub Company as tenanted and leased businesses face greater competitive and growth hurdles than managed pubs.

Leinster said: "We believe their assets are generally better

quality than the balance of the market, but they need to redress the beer-tie in a more creative way than substituting it for higher fixed rent. Greene King has begun to do so, lately with its Blueprint lease, which is a hybrid of a turnover-based lease. Marston's, in our view, is the only pub company taking a really radical approach with their Retail Agreement. It is like a franchise agreement and only works because of the buying power and expertise of the managed business that provides the pubs' inventory."

In the light of more managed pubs are becoming more restaurant-like, UBS said it did not share the commonly held view that the eating out market is in growth.

Leinster said: "Eating out as a share of total food sales peaked in 2005 in the UK. In the U.S. the share of meals eaten in restaurant and fast food venues peaked in 2001, long before the economic downturn. We believe the main reason for this is that the share of women over 16 who work has not grown for several years; at about 57% in the UK.

"That is not to say the eating out market is a poor one, but we are suggesting that the backdrop is not as constructive as some believe, and it is no panacea for a poorly invested, poorly located pub. Certainly food sales in pubs have grown, but we believe pubs are taking share from other casual dining formats. In the long-term, we would expect the industry to grow with discretionary consumer spending."

The analyst said that he expects the organic growth in the leased and tenanted pub business to be less than inflation.

"Overall the UK consumer is not drinking less alcohol, but

is drinking more of just about anything other than beer. Wine has been the primary substitution, and since it is often taken with meals, has changed the drinking occasion.

"We see no reason to expect beer demand to stop falling in the near-term. We do not believe price growth is a viable strategy for pub operators to deal with falling underlying demand. Beer, or lager at least, is a commodity item so pub operators need to be mindful of what they charge relative to shop retailers. In sum, we believe profit growth from tied beer will be positive in the longer-term but growth will be less than inflation."

UBS has downgraded Enterprise Inns' rating to Sell with an 85p target.

Leinster said: "In the near-term the company is selling assets to shore up the balance sheet and to exit what are now considered unviable pubs. While this should help stabilise the business, we are concerned that just short of 20% of the remaining licensees have been in their pub for only one year. In the longer-term we believe traditional lease profits will grow at less than the rate of inflation.

"We are downgrading JDW's rating from Buy to Neutral Following a strong share price move over the last six months, we are downgrading JDW on valuation grounds. We continue to be optimistic about the new opening programme. We assume the margin funk the business is now in is temporary and margins will return to a more normal 10% in just over one year's time."

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Barry Voysey

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[Brakspear boss: Britain is "over-pubbed" 20/06/2011](#)
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Tom Davies, chief executive of Oxfordshire-based Brakspear pub company, has said it's "inevitable" that more pubs will close as Britain is "over-pubbed".

He told the Henley Standard that pubs "just can't survive" if they're only used by "the odd customer to pop in for a Sunday lunch".

Davies said: "I firmly believe that as a nation we are over-pubbed because the way people use them has changed. There are places that used to get by on a core of drinkers and customers that are simply not viable as business sites any more."

"Village pubs used to have a tight community of locals but instead the homes around them are full of commuters or

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are second homes. Suddenly that trade is gone.

"It's massively important to the UK that we keep our pubs. Brakspear is out-performing the market when it comes to closures but times are still hard and pubs need support."

Davies, who oversees an estate of 145 tenanted pubs, said Brakspear does its "very best" to ensure rents aren't increased unnecessarily.

"That is one way that we support our tenants but not all of them can maintain some sites. We take prospective landlords through a rigorous process of assessment so that they will know the pitfalls of what they are getting themselves into."

He also hit out at the "immoral" action of supermarkets that sell alcohol at a loss leader and making life tougher for pubs.

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