# Financial review

# REVENUES REACHED A RECORD HIGH

**GROUP REVENUE INCREASED:**

**6.9%**

**FREE CASH FLOW:**

**£119.6m**

**ROCE:**

**9.4%**

**DIVIDEND:**

**33.2p**

## Income statement

Revenue was £2,216.5m, an increase of 6.9% compared to the prior year reflecting the benefit from LFL sales growth and a full year contribution from Spirit. Pub Company was the biggest driver of the increase, with revenue up 7.7% and average revenue per pub rising 3.4%. The combined Pub Company business now accounts for over 82% of group revenue. Total revenue in Pub Partners was £198.8m. Average tenanted and leased revenue per pub increased 5.5% and average EBITDA per pub grew 7.9% due to the improved quality of the pub estate and also benefiting from fair value accounting and the inclusion of synergies. Brewing & Brands grew revenue 1.7% to £200.3m.

Operating profit before exceptional and non-underlying items was £411.5m, which was an increase of 4.9% on the prior year. Group operating profit margin before exceptional and non-underlying items was down 30 basis points to 18.6%, reflecting a higher contribution from the managed estate and, within this, a reduction in Pub Company margin from 17.7% to 17.0%. The reduction of the Pub Company margin reflected our ongoing investment in value, service and quality, alongside significant inflationary increases in the cost of goods sold and labour.

Net interest costs before exceptional and non-underlying items were £138.0m, 1.7% higher than last year due to the full year impact of Spirit debt costs partially offset by refinancing activities in the year.

Profit before tax and exceptional and non-underlying items was £273.5m, an increase of 6.6% on last year. The tax charge before exceptional and non-underlying items equated to an effective tax rate of 19.9% (2016: 19.3%).

Basic earnings per share before exceptional and non-underlying items of 70.8p was up 1.3%. Statutory profit before tax was £184.9m, down 2.6% on last year.

## Cash flow and capital structure

Operating cash flows remained very strong. We generated free cash flow of £119.6m, ahead of our scheduled debt repayments of £55.0m and after our core capital expenditure and dividend payments. Free cash flow benefited from favourable working capital timing, a small reduction in core capex as we focused on brand conversions and the utilisation of non-recurring Spirit tax losses. Overall, EBITDA before exceptional and non-underlying items was £524.1m.

In October, we agreed an amendment and extension to our revolving credit facility. The revised £400m facility runs to 31 October 2021 and provides shorter-term financing at more favourable pricing than the previous facility.

Group net debt at the year end was £2,074.5m, an increase of £26.1m from last year.

In line with our strategic priorities, our objective is to maximise the strength of our balance sheet, and the group has a capital structure aimed at meeting the short, medium and longer-term funding requirements of the business. The principal elements of the group's capital structure are our revolving credit facility, that was £170m drawn at the year end, and two long-term asset-backed financing vehicles. At the year end, the Greene King securitisation had secured bonds with a carrying value of £1,392.5m and an average life of eleven years, secured against 1,464 pubs with a carrying value of £1.7bn and valuation at the time of issuance of £2.2bn. The Spirit debenture had secured bonds with a carrying value of £777.6m and an average life of eleven years, secured against 1,010 pubs with a market value and carrying value of £1.5bn.

Our credit metrics remain strong with 96% of our interest costs at a fixed rate and an average cash cost of debt of 6.3%. Fixed charge cover was maintained at 2.3x and net debt to EBITDA increased slightly to 4.0x from 3.9x last year. The Greene King secured vehicle had a free cash flow debt service cover ratio of 1.7x at the year end, giving 35% headroom. The Spirit debenture vehicle had a free cash flow debt service cover ratio of 1.9x giving headroom of 32%.

## Capital expenditure and disposals

During the year, we invested in both maintaining and developing our existing estate. Total capital expenditure during the year was £194.9m with a further £39.1m of expenditure relating to pub repairs and maintenance recorded in the income statement. Core estate capital expenditure was £126.0m with a further £35.9m invested in acquiring pubs and developing previously acquired pubs. There were eleven new pub openings during the year. We also invested £33.0m in our brand conversion and IT integration programme.

We disposed of 65 pubs in Pub Company, 54 pubs in Pub Partners and three closed pubs, which led to a profit on disposal of £3.4m and raised proceeds of £88.6m.

## Return on capital employed (ROCE)

The group is focused on delivering the best possible returns on our assets and on the investments we make. We are focused on capital discipline, through targeted investment in new build pubs, single site acquisitions and in developing our existing estate to drive organic growth with disposals of non-core pubs. This has contributed to maintaining ROCE at 9.4%. ROCE remains comfortably ahead of the group's cost of capital.

## Dividend

The board has recommended a final dividend of 24.4p per share, up 3.4%, subject to shareholder approval. This will be paid on 15 September 2017 to shareholders on the register at the close of business on 11 August 2017.

The proposed final dividend brings the total dividend for the year to 33.2p per share, up 3.6%. This maintains our long-term track record of annual dividend growth and is in line with the board's policy of maintaining a minimum dividend cover of around two times underlying earnings, while continuing to invest for future growth.

## Tax

The effective rate of corporation tax (before exceptional and non-underlying items) was 19.9%, which is in line with the standard UK corporation tax rate, compared to 19.3% in the previous year. This resulted in a charge to operating profits (before exceptional and non-underlying items) of £54.3m (2016: £49.4m). The exceptional and non-underlying tax credit of £21.1m (2016: £50.5m) is discussed under exceptional and non-underlying items.

The group generates revenue, profits and employment, all of which deliver substantial tax revenues for the UK government in the form of duties, VAT, income tax and corporation tax. In the year, total tax revenues paid and collected by the group were £580m (2016: £570m). The group's tax policy, which has been approved by the board, aligns with this strategy and ensures that the group fulfils its obligations as a responsible UK taxpayer.

> **"THE TOTAL DIVIDEND FOR THE YEAR IS 33.2P PER SHARE.**

On 6 June 2016, a formal agreement was reached with HMRC on a number of historical tax positions and on 22 July 2016 the Court of Appeal published its final decision on the Sussex case. As a result, the group settled tax of £20.7m and interest of £12.2m during the year.

We have one remaining open historical position with HMRC, which is an internal property arrangement implemented in 2012. The group is at a relatively early stage in discussions with HMRC and will continue to defend its position robustly.

The provisions for uncertain tax positions and related interest accrued at the balance sheet date were £8.0m (2016: £31.6m) and £1.9m (2016: £13.8m) respectively.

## Pensions

The group maintains three defined contribution schemes, which are open to all new employees, and two defined benefit schemes, which are closed to new entrants and to future accrual.

At 30 April 2017, there was an IAS 19 pension deficit of £11.2m representing a reduction of £41.1m since the previous year end. The closing assets of the group's two pension schemes totalled £888.0m and closing liabilities were £899.2m compared to £801.2m and £853.5m respectively at the previous year end.

The deficit reduced due to strong asset returns and contributions made by the group during the year, combined with the impact of changes to market-based discount rates and inflation assumptions.

Total cash contributions in the year were £3.9m for past service.

The next triennial reviews for both the Greene King and Spirit pension schemes will be as at April 2018 and are due by July 2019.

## Exceptional and non-underlying items

We recorded an exceptional and non-underlying items charge of £67.5m, consisting of a £65.0m charge to operating profit before tax, a £23.6m charge to finance costs and a net exceptional and non-underlying tax credit of £21.1m. Items recognised in the year included the following:

1. A £10.8m charge for legal, professional, integration and reorganisation costs following the Spirit acquisition.

2. A net impairment charge of £58.6m (2016: £32.2m) was made against the carrying value of our pubs and other assets. This comprises an impairment charge of £77.7m offset by reversals of previously recognised impairment losses of £19.1m. A £23.7m impairment charge has been recognised in relation to a small number of pubs due to changes in the local trading environment and a further £34.9m of impairment has been recognised following the planned exit of certain sites during the current financial year.

3. A net surplus on disposal of property, plant and equipment of £3.4m (2016: £23.8m).

# Financial review continued

## Exceptional and non-underlying items continued

4. £23.6m of exceptional and non-underlying finance costs, which includes £23.6m of costs in respect of the mark-to-market movements in the fair value of interest rate swaps not qualifying for hedge accounting, £11.8m of costs recycled from the hedging reserve in respect of settled interest rate swap liabilities and a £12.2m gain on settlement of interest rate swap liabilities.

5. The exceptional and non-underlying tax credit of £21.1m consists of a £5.0m tax credit on exceptional items, a £2.8m tax credit on non-underlying items, a deferred tax credit of £9.5m in respect of the licensed estate, a £0.5m tax charge in respect of prior periods and a £4.3m tax credit in respect of rate changes.

Of the £67.5m total exceptional and non-underlying items charge, cash expenditure was £47.3m relating primarily to integration costs of £14.4m and settling £32.9m of historical tax positions with HMRC.

## Guidance for financial year 2017/18

We expect total gross cost inflation of around £60m and, after our cost mitigation plans of £40–45m, we expect net cost inflation of £15–20m.

In Pub Company, we anticipate opening c.10 pubs and disposing of 50–60 pubs.

In Pub Partners, we expect to dispose of 40–50 pubs. These disposals will continue to improve the quality of the estate while generating cash for other uses across the business.

We anticipate spending £130–145m, excluding brand optimisation capex, on maintaining and developing our pubs, in order to ensure they remain attractive places for customers to spend their time.

Spend on the brand optimisation programme is expected to total £30–40m – out of a total spend over four years of £120–150m – and we are targeting EBITDA returns significantly ahead of our cost of capital.

New build development capex is expected to be £30–40m.

We expect the interest charge to be in the region of £135–140m when taking into account the charge relating to our debt facilities, pensions and provisions.

The pre-exceptional tax rate is expected to be c.19%.

**Kirk Davis**
**Chief financial officer**
28 June 2017