Financial review

STRONG AND FLEXIBLE BALANCE SHEET

"OUR NEW BANK FACILITY WILL IMPROVE THE GROUP'S ABILITY TO REFINANCE SPIRIT SECURED LOANS.

FREE CASH FLOW[2]:

£89.9m

ROCE[2]:

8.5%

DIVIDEND:

33.2p

Income statement

£ million	52 weeks ended 29 April 2018	52 weeks ended 30 April 2017
Revenue	**2,176.7**	2,216.5
Adjusted operating profit[1]	**373.1**	411.5
Adjusted net finance costs[1]	**(130.1)**	(138.0)
Adjusted profit before tax[1]	**243.0**	273.5
Exceptional and non-underlying items	**(45.5)**	(88.6)
Profit before tax	**197.5**	184.9

Revenue was £2,176.7m, a decline of 1.8% compared to the prior year, reflecting lower Pub Company LFL sales, somewhat impacted by snow, and the impact of the non-core pub disposal programme. Pub Company was the biggest driver, with revenue down 2.7% to £1,767.7m. Non-core disposals helped AWT per pub rise 1.6%. The Pub Company business accounts for 81% of group revenue. Total revenue in Pub Partners was £193.9m. Tenanted and leased AWT per pub increased 2.4% and average EBITDA per pub grew 3.1% due to the continuing improvement in the quality of the pub estate. Brewing & Brands grew revenue 7.4% to £215.1m due to increasing the number of new customers.

1. Adjusted measures exclude the impact of exceptional and non-underlying items.
2. An explanation of the group's use of alternative performance measures (APMs), including definitions and reconciliations, is included in the glossary on page 128.

Operating profit before exceptional and non-underlying items was £373.1m, which was a decline of 9.3% on the prior year. Group operating profit margin before exceptional and non-underlying items was down 1.5%pts to 17.1%, reflecting a reduction in both Pub Company margin from 17.0% to 15.2% and Brewing & Brands margin from 15.5% to 14.3%. The reduction in the Pub Company margin reflected the group's ongoing investment in value, service and quality, alongside significant inflationary increases in cost of goods sold and labour, which were not fully mitigated through management actions.

Net interest costs before exceptional and non-underlying items were £130.1m, 5.7% lower than last year due in part to the impact of refinancing activities in the year.

Profit before tax, exceptional and non-underlying items was £243.0m, 11.2% lower than last year.

Basic earnings per share before exceptional and non-underlying items of 62.7p was down 11.4%. Statutory profit before tax was £197.5m, up 6.8% on last year.

Tax

The effective rate of corporation tax (before exceptional and non-underlying items) of 20.0% is higher than the standard UK corporation tax rate of 19.0% due to non-qualifying depreciation, compared to 19.9% in the previous year. This resulted in a charge to operating profits (before exceptional and non-underlying items) of £48.6m (2017: £54.3m). The exceptional and non-underlying tax credit of £13.6m (2017: £21.1m) is discussed under exceptional and non-underlying items.

The group generates revenue, profits and employment that deliver substantial tax revenues for the UK government in the form of VAT, duties, income tax and corporation tax. In the year, total tax revenues paid and collected by the group were £580m (2017: £580m). The group's tax policy, which has been approved by the board, has the objective of ensuring that the group fulfils its obligations as a responsible UK taxpayer.

On 16 October 2017 agreement was reached with HMRC regarding an internal property arrangement, the group's only material unresolved historical tax position. As a result, the group settled tax of £9.4m and interest of £2.1m during the year.

Exceptional and non-underlying items

Exceptional and non-underlying charges were £31.9m, consisting of a £56.1m charge to operating profit, a £10.6m credit to finance costs and a net exceptional and non-underlying tax credit of £13.6m. Items recognised in the year included the following:

1. A £5.6m charge for legal, professional and integration costs following the Spirit acquisition and in relation to group refinancing activities and defending uncertain tax positions.
2. A net impairment charge of £70.4m (2017: £58.6m). Of this total, a net £63.3m charge was made against the carrying value of pubs and other assets.
3. A net surplus on disposal of property, plant and equipment of £19.7m (2017: £3.4m).
4. The £10.6m credit for exceptional and non-underlying finance costs includes a £19.2m gain in respect of the mark-to-market movements in the fair value of interest rate swaps not qualifying for hedge accounting, £11.6m of costs recycled from the hedging reserve in respect of settled interest rate swap liabilities and a £3.0m gain on the settlement of financial liabilities.
5. The exceptional and non-underlying tax credit of £13.6m consists of a £0.2m tax charge on exceptional items, a £2.9m tax credit on non-underlying items, a £3.1m tax charge in respect of prior periods and a £14.0m tax credit in respect of the licensed estate.

Cash flow and capital structure

£ million	52 weeks ended 29 April 2018	52 weeks ended 30 April 2017
Adjusted EBITDA[1]	**486.6**	524.1
Working capital and other movements[2]	**(22.9)**	(14.8)
Net interest paid[2]	**(127.1)**	(134.9)
Tax paid[2]	**(9.4)**	(28.0)
Adjusted cash generated from operations	**327.2**	346.4
Core capital expenditure	**(132.2)**	(126.0)
Dividend	**(102.9)**	(100.1)
Net repayment of trade loans/ other non-cash movements	**(2.2)**	(0.7)
Free cash flow	**89.9**	119.6
Disposal proceeds	**117.5**	88.6
New build/brand conversion capital expenditure	**(61.0)**	(68.9)
Exceptional and non-underlying items/share issues	**(61.6)**	(48.0)
Payment of derivative liabilities	**(42.6)**	(117.4)
Change in net debt	**42.2**	(26.1)

The group continued to be highly cash generative with free cash flow of £89.9m, after funding core capital expenditure of £132.2m and dividend payments of £102.9m. This is significantly ahead of scheduled debt repayments of £52.6m. Disposal proceeds at £117.5m reflected our ongoing programme of estate optimisation and we invested £61.0m in nine new builds and 106 brand conversions.

The group disposed of 38 pubs in Pub Company, 50 pubs in Pub Partners and four closed pubs, raising proceeds of £123.9m, which was partially offset by exiting a small number of leases.

In November 2017 the group amended its existing £400m revolving credit facility to incorporate an additional £350m three-year revolving facility, taking total bank facilities to £750m. The new facility is available to fund the internal transfer of pubs from the Spirit secured financing vehicle, improving the group's ability to refinance Spirit secured loan notes and related interest rate swaps. Pubs released from the Spirit debenture increase the group's unsecuritised portfolio, improving flexibility.

During the year the group settled financial liabilities in relation to the Spirit secured financing vehicle, recognising a net gain of £3.0m. The financial guarantee provided by Ambac in respect of a number of Spirit secured bonds was terminated for a cash consideration of £12.6m with a further £2.2m being paid in respect of consent and other fees. The fair value of this off-market contract liability was initially recognised as part of the acquisition fair values of Spirit Pub Company. An exceptional gain of £5.9m has been recognised, being the difference between the carrying value of the liability and the total cash consideration and fees incurred in order to terminate it.

In addition the A1, A3, A6, and A7 Spirit secured bonds were fully repaid at their par value of £216.9m. This eliminates the cash sweep and 1.5% margin step-up on the £160m A6 and A7 bonds which was due to commence in September 2018.

1. Adjusted EBITDA represents earnings before interest, tax, depreciation, amortisation and exceptional and non-underlying items.
2. Adjusted measures exclude the impact of exceptional and non-underlying items.

Financial review continued

Cash flow and capital structure continued

The group has recognised exceptional losses on early settlement of £4.1m, being the difference between the carrying value of the bonds and their par value on prepayment. The group also terminated two interest rate swap contracts for cash consideration of £42.6m in connection with the repayment of these notes, recognising an exceptional gain of £1.2m amounting to the discount received on termination.

The total cash flow impact of refinancing accounted for £14.8m of the £61.6m exceptional/non-underlying cash flow reported.

In line with our strategic priorities, the group's objective is to maximise the strength and flexibility of its balance sheet, and maintain 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 its revolving credit facilities that were £277m 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 £1,343.5m and an average life of ten years, secured against 1,429 pubs with a carrying value of £1.7bn. The Spirit debenture had secured bonds with a carrying value of £563.6m and an average life of nine years, secured against 872 pubs with a carrying value of £1.1bn.

The group's credit metrics remain strong with 94.4% of net interest costs at a fixed rate and an average cash cost of debt of 6.1%. Fixed charge cover slightly reduced to 2.2x from 2.3x last year and net debt to EBITDA increased slightly to 4.2x from 4.0x last year. The Greene King secured vehicle had a free cash flow debt service cover ratio of 1.5x at the year end, giving 28% headroom. The Spirit debenture vehicle had a free cash flow debt service cover ratio of 1.9x, giving 33% headroom.

Overall our net debt reduced in the year by £42.2m to £2,032.3m.

Balance sheet

£ million	29 April 2018	30 April 2017
Goodwill and other intangibles	**1,214.4**	1,272.5
Property, plant and equipment	**3,597.8**	3,627.0
Post-employment assets/(liabilities)	**13.6**	(11.2)
Net debt	**(2,032.3)**	(2,074.5)
Derivative financial instruments	**(241.1)**	(344.8)
Other net liabilities	**(495.5)**	(524.8)
Net assets	**2,056.9**	1,944.2
Share capital and premium	**300.7**	300.4
Reserves	**1,756.2**	1,643.8
Total equity	**2,056.9**	1,944.2

"THE GROUP'S CREDIT METRICS REMAIN STRONG.

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 29 April 2018, there was an IAS 19 pension asset of £13.6m representing an improvement of £24.8m since the previous year end. The closing assets of the group's two pension schemes totalled £859.2m and closing liabilities were £845.6m compared to £888.0m and £899.2m respectively at the previous year end.

The improvement in position is due to 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 £3.6m for past service.

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

Return on capital employed

The group is focused on delivering the best possible returns on its assets and on the investments it makes and is focused on capital discipline, through targeted investment in new build pubs, single-site acquisitions and in developing its existing estate to drive organic growth with disposals of non-core pubs. ROCE of 8.5% has declined 90 bps compared to the prior year primarily due to lower Pub Company profits. ROCE remains comfortably ahead of the group's cost of capital.

Dividend

The board has recommended a final dividend of 24.4p per share, in line with last year, subject to shareholder approval. This will be paid on 14 September 2018 to shareholders on the register at the close of business on 3 August 2018.

The proposed final dividend brings the total dividend for the year to 33.2p per share, in line with last year. This is in keeping with the board's policy of maintaining dividend cover of around two times underlying earnings, while continuing to invest for future growth.

Richard Smothers
Chief financial officer
27 June 2018