Chief executive's review

RESILIENCE AND GOOD PROGRESS

"WE HAVE MADE GOOD PROGRESS ON KEY INITIATIVES AND WE HAVE A STRONG STRATEGY TO DRIVE MOMENTUM.

GROUP REVENUE WAS:

£2,176.7m

OPERATING PROFIT BEFORE EXCEPTIONAL AND NON-UNDERLYING ITEMS WAS:

£243.0m

DIVIDEND IN LINE WITH LAST YEAR:

33.2p

Greene King has shown its resilience and made good progress on key initiatives which drove an improvement in the momentum of the business during a year of unprecedented cost inflation, weak consumer confidence and increased competition. Snowy weather impacted trading in the second half of the year but our £10m VSQ customer investment helped to improve underlying Pub Company trading. Pub Partners delivered another year of increased LFL net profit while Brewing & Brands grew revenue by 7.4% in a declining beer market. We have a strong strategy in place to continue driving momentum in the top line, to mitigate costs and to deliver value to our customers, our employees, our shareholders and our communities.

Performance summary

Total revenue was down 1.8% to £2,176.7m as a result of the challenging market conditions and poor weather. EBITDA[1,2,3] was £486.6m, down 7.2% and operating margin[1,2] decreased 1.5%pts to 17.1%, reflecting the net cost inflation seen in the year as well as the VSQ investment in Pub Company. Profit before tax, exceptional and non-underlying items[1,2] was £243.0m, in line with market expectations.

Pub Company revenue was £1,767.7m, down 2.7% due to the tough trading conditions and the 4.4% decrease in the average number of pubs trading, while average weekly take (AWT) was up 1.6% to £19.6k. Pub Company EBITDA[1,2,3] was down 10.0% to £362.9m and operating profit margin[1,2] was down 1.8%pts to 15.2% due to the increased cost pressures, as well as the VSQ investment.

1. Adjusted measures exclude the impact of exceptional and non-underlying items as detailed in note 5 of the financial statements.
2. The directors use a number of alternative performance measures (APMs) that are considered critical to aid the understanding of the group's performance. APMs are explained on page 128 of this annual report.
3. EBITDA represents earnings before interest, tax, depreciation, amortisation and exceptional and non-underlying items and is calculated as operating profit before exceptional and non-underlying items adjusted for the depreciation and amortisation charge for the year.

Pub Partners revenue was £193.9m, down 2.5% on last year, driven by the 4.7% decrease in average pubs trading. EBITDA[1,2,3] was down 1.7% to £101.3m while average EBITDA[1,2,3] per pub was up 3.1% to £88.9k, reflecting our continued estate optimisation.

Brewing & Brands achieved strong revenue growth, up 7.4% to £215.1m, driven by increased sales from free trade and exports. EBITDA[1,2,3] was down 0.6% to £36.0m and operating profit margin[1,2] was down 1.2%pts to 14.3%, reflecting the change in product and channel mix.

Free cash flow before disposal proceeds was down 24.8% to £89.9m and our cash generated more than covers our debt service obligation, core capex expenditure and dividend payments.

Adjusted earnings per share[1,2] was down 11.4% to 62.7p and the board has recommended a dividend per share of 33.2p, in line with last year.

The businesses generated a strong return on capital employed (ROCE) of 8.5%, which remains comfortably above our weighted average cost of capital (WACC).

Trading environment

The current trading environment is still characterised by subdued consumer confidence, intense competition and rising costs.

Consumer confidence improved slightly since the lows of December 2017, but remains negative (source: GfK) and consumers expect to continue reducing leisure spend (source: Deloitte Consumer Tracker Q1 2018).

Consumers are keeping a keen eye on costs and continue to expect more for their money. Other aspects of their behaviour are changing faster than ever. Spirit-based drinks and breakfast are growth areas for pubs, as are event-driven customer occasions, both in terms of key calendar events and in terms of our customers' own events. Health and diet remain key trends and consumers also favour brands associated with local and fresh produce. Quick service and convenience are also important to the consumer and have driven technological innovation such as order and pay apps and the rise of delivery services.

Competition for market share is intense, particularly in the food-led sector, with the overall number of restaurant outlets in the UK still on the rise, up 16.7% over the last five years, and food-led pub numbers up 4.7%. Total pub numbers reduced by 10.3% however, driven by a 16.9% reduction in drink-led pub numbers since 2012 (source: CGA and AlixPartners Market Growth Monitor, April 2018). Demand for drink-led pubs is holding up though with LFL sales growth of 1.7% over the last 12 months versus a decline of 0.4% in pub restaurants and a 0.1% decline in restaurants (source: Coffer Peach Business Tracker, April 2018).

The cost environment remains challenging and, while we succeeded in mitigating £44m of the £60m gross inflation in the year, we expect there to be further cost inflation of around £45–50m in the new financial year, driven by the National Living Wage, sugar tax, utility taxes and business rates. Through the execution of our strategy outlined below we are targeting a return to LFL sales growth in the new financial year supported by additional cost mitigation of £30–35m. Through our planned cost savings programme, we will seek to increase our agility and competitiveness and be more effective at capturing sales opportunities in our main markets.

The garden at The Didsbury, a Chef & Brewer pub in Didsbury

> 2,700 APPRENTICES JOINED OUR APPRENTICESHIP SCHEME THIS YEAR.

People

We spent over £3m in training and development in the year. We also launched our new online training platform, available to all our 39,000 employees, enabling company-wide training on areas such as safety and compliance, as well as more reactive and targeted training programmes, such as early stage inductions and social media training. Around 150,000 courses have been completed on the platform so far. We also launched Wellbeing Week to raise awareness about physical and mental health in the workplace and we launched networks for women and members of the LGBT+ community.

Our continued investment in training and development, together with our competitive employee benefits scheme, has led to improved engagement levels and a steady rate of turnover. Our average length of service for pub general managers is 7.4 years and for kitchen managers it is 4.5 years. We will seek to improve the future retention rate through the training initiatives detailed above, especially a quality induction programme, and greater engagement with our employees through digital HR and ongoing focus on our Winning Ways programme, which we launched last year.

The apprenticeship scheme has now supported over 10,000 apprentices with 92% of our pubs having benefited from the programme and 71% of our pubs with an apprentice currently in training. The scheme continues to attract high levels of applicants and 2,700 apprentices joined the scheme this year. We were pleased to win awards from the National Apprenticeship Service (Top 100 Apprenticeship Employer), East of England Apprenticeship Awards (Macro Employer of the Year), and the Training Journal (Best Apprenticeship Programme) in recognition of our investment in apprentices.

Community

Pubs are at the heart of communities across the country and are a force for good in those communities.

We are extremely proud of our national charity partnership with Macmillan Cancer Support, which to date has raised over £4m with record fundraising results of over £1m over the last year.

We ran eight Get into Hospitality programmes this year in association with The Prince's Trust and were able to celebrate one of our first Prince's Trust recruits going on to complete our apprenticeship programme. A further 20 Prince's Trust recruits are currently enrolled on an apprenticeship with Greene King.

In addition, this was our fifth year donating to the Pub is the Hub Communities Fund, supporting rural pubs that want to diversify their services for the benefit of their local communities.

Outlook

Over the first eight weeks of the new financial year LFL sales in Pub Company were up 2.2%, benefiting from better weather and strong sporting fixtures as well as the investments we made in the second half of the year on value, service and quality for our customers. We are continuing to see strong drink sales growth, achieving record Pub Company drink sales in May, and we are starting to see the benefits from the World Cup, as more than half of consumers expect to watch an England game at the pub. Pub Partners and Brewing & Brands are trading in line with expectations. For the new financial year we expect £45–50m cost inflation and we are targeting £30–35m cost savings and Pub Company LFL sales growth.

Rooney Anand
Chief executive officer
27 June 2018