EDISON

Pubcos: MRO update

'Market rent only' option will change the sector

Travel & leisure

Legislation effective today makes it possible for pub tenants to set aside the traditional drinks tie with pub companies, and instead buy their drinks from cheaper sources. The issue has been in prospect since late 2014 and has been folded into companies' strategies where relevant, with estate management actions well advanced and active engagement with tenants. These will change the sector in ways that the sponsors of the legislation did not intend. We anticipate less immediate disruption than headlines would suggest, although the inevitable uncertainty comes at exactly the wrong time given the post-Brexit hit to consumer confidence.

Pub companies without the drinks tie: Potential threat

The pub industry is no stranger to government intervention, and the latest manifestation of that has been the provision in the Small Business, Enterprise and Employment Act 2015 that allows pub tenants to opt out of the traditional drinks tie, restricting their obligation to 'market rent only' (MRO). This has just become law, although the effective impact is likely to be spread over the next five years.

The legislation is a potential risk to the income of companies with leased and tenanted trading estates, although those with either managed or small tenanted estates (less than 500 leased and tenanted pubs) are not directly affected. Since the Commons vote in December 2014, companies with potential exposure have had the opportunity to address it in their strategies, which we consider in this report, along with a brief review of all major pub companies.

Unintended consequences in a resilient industry

Rather like 2007, when a piece of disruptive regulation (in that case the smoking ban) was followed shortly afterwards by the financial recession, the MRO legislation will not help pub companies, which have now also to contend with the effects of Brexit on consumer confidence. However, this highly adaptive industry has bounced back from many wars and recessions in the past. It is already clear that one way in which it will deal with this issue is to reduce the number of pubs available for lease and tenancy, in favour of other formats such as franchising.

Valuation: A cocktail of issues

Following the Brexit vote, most pub companies' shares have taken a value hit over the last month, with share prices lower by an (unweighted) average of 7%. But pub companies that have the most leases and tenancies are not necessarily the lowest priced. For example, the wholly managed Mitchells & Butlers, at a prospective consensus EV/EBITDA multiple of 6.5x, stands at a discount to both Enterprise Inns (9.3x) and Punch Taverns (7.9x). Other factors affecting the sector that go beyond our scope here are operational and financial gearing, dividend prospects, growth record, regional exposure, return on investment, cash constraints, governance and of course management. Holders of pub company shares will need to be realistic about the period for returns to be restored. Longer-term investors may regard current weak perceptions as an opportunity to take a stake in a sector that has demonstrated plenty of recovery potential over time.

21 July 2016

Companies included

	Share price	Market cap	EV
	p	£m	£m
Enterprise Inns	89	442	2,712
Fuller Smith & Turner	975	545	739
Greene King	787	2,433	4,472
Marstons	138	796	1,951
Mitchells & Butlers	243	1,007	2,905
Punch Taverns	88	194	1,421
Shepherd Neame	1,175	174	235
JD Wethersoon	802	911	1,537
Young & Co	1,214	535	665
Source: Bloomberg			

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Note: All shares priced at 21 July 2016.

MRO: Unwelcome but not unexpected

On 18 November 2014, the House of Commons, by a majority of only 15, voted through the Small Business, Enterprise and Employment Act 2015, which included the provision that pub licensees should be able to opt for a market rent only (MRO) basis for their lease. The 'market rent only' basis represents a departure from traditional practice, under which the pub owning companies (originally breweries) derive both rental and product-based income under the tie, the system under which the tenant pays rent to the pub company and also has to purchase beer (and other drinks) exclusively from it, with rents often reduced below market levels. This in turn allowed the pub company either to take a volume-based profit if it brewed beer itself, or secure discount income if it purchased beer and other drinks from a third party. To the extent any pubs adopt an MRO option, the pub company is denied any volume-related element in its profits, effectively restricting it to the role of a property company, and thus reducing its income from the pub. It is generally expected that any rent increases from discounted levels to market rent levels will be inadequate to fully compensate.

The MRO provisions will apply to companies that are the landlord of 500 or more pubs. However, although the Act received Royal Assent in March 2015, the relevant detailed provisions are contained in secondary legislation that has three elements: a statutory Pubs Code dealing with all aspects of the landlord-tenant relationship, the appointment of an independent adjudicator, and the market rent only option for lessees.

Paul Newby, a director of pub property agent Fleurets, was appointed Pubs Code adjudicator in March 2016. Following consultation on the whole of the secondary legislation, which concluded in April 2016, its implementation date was scheduled for 26 May 2016. However, as a result of identification of certain drafting errors, the process was extended. Finally, despite disruption to government following the Brexit outcome, it became law today, 21 July 2016, just ahead of the Summer Recess.

Background

The MRO legislation addresses the conclusion of the 2010-11 House of Commons Business, Innovation and Skills Committee report, which reviewed the implementation of previous recommendations: "Our predecessor's recommendation [this referred to the 2008-09 Inquiry: Pub Companies] clearly stated that over a period of time all existing lessees and all new lessees should be offered a free of tie lease with an open market rent review based on RICS (Royal Institute of Chartered Surveyors) guidance. This recommendation was endorsed by the then Government. Despite this clear instruction... the industry has shown itself unable or unwilling to deliver meaningful reform."

That report was the latest in a series of government enquiries and regulations affecting the pub industry over the last 50 years, prominent effects of which have been drink-driving laws introduced in 1965, the anti-monopoly provisions of the so-called Beer Acts of 1980-81 and the smoking ban of 2007.

Over the last 10 years in particular, there has been an increased level of protest from pub tenants against the combination of rent obligations and perceived high prices for beer. Market conditions have changed over time as a result of changes in society, the 2008-09 financial crisis and the regulations quoted above. However, an Office of Fair Trading investigation ruling in 2009 was confirmed in October 2010 to the effect that the beer tie was not anti-competitive, effectively refusing to interfere in the contractual terms agreed between landlord and tenant.

Effects of MRO

Exhibit 1: Number of pubs by trading format

	Managed	Leased & tenanted	Franchised/retail agreement	Commercial property	Total
Enterprise Inns	75	4,638		264	4,977
Fuller Smith & Turner	195	203			398
Greene King	1,823	1,147	65		3,035
Marston's	503	439	628		1,570
Mitchells & Butlers	1,779		55		1,834
Punch Taverns		3,259	71		3,330
Shepherd Neame	59	269		7	335
JD Wetherspoon	954				954
Young & Co	171	80			251

Source: Companies

Timing: Spread over a period

Under the legislation, MRO can only be initiated on the occurrence of a "trigger event". This is most often likely to be a rent review or lease renewal date, although it could also include a significant product price increase or a material change in circumstances. Franchised (as opposed to leased) pubs are specifically excluded from MRO, and there is also an exemption if there is a significant investment project. For this purpose, "significant" is generally defined as being twice the annual rent. Most trigger events are spread over the next five years as either short-term tenancies come up for renewal, or longer-term leases (mostly up to 10 years) hit rent review dates.

Returns: Less attractive

From the pubco company's perspective, to the extent MRO is adopted by a pub, that pub may become less attractive as a business asset. This depends on the profile of the pub: for instance income from a pub whose income is mainly through food would be less affected, but tenants most likely to opt out of MRO are naturally those where drink volumes are relatively high. The income achievable from rent only will not generally justify the company's cost in distributing beer and other products, or of operational management through the area manager network. As a result, such pubs would become property investments only, and must justify themselves or not on those terms. They could be disposed of in order to free up capital that the company believes can be invested in higher returning assets.

Brewing: A hidden benefit

Companies that still brew beer and distribute it to the free trade (four of the nine we review here) are likely to benefit from increased numbers of customers to the extent tenants taking advantage of MRO start to buy beer for themselves. The terms they are able to negotiate are likely to be inferior to those of the big pub owning groups, even if they form co-operatives for the purpose. Net of reductions from national accounts, this may not be very material, but potentially represents a rare win for brewing operations contending with long-term declines in beer consumption.

Specific effects

We list below some of the consequences that we expect:

- A proportion of pubs approaching a trigger event each year will opt for MRO, although the number that will actually do so is uncertain.
- Pub companies will try to dissuade tenants from exercising the option.
- If the trigger event is a lease renewal, there is no obligation on the company to renew with that tenant. Companies will be active in consulting with tenants on this issue in advance.

- A proportion of tenants who are either content with a business model under which they receive trading support and advice, or not confident enough to go independent, or else who accept that an MRO model may not be sustainable for their relationship with the company, will opt to remain on existing terms.
- Pub companies may incentivise tenants to remain by proposing significant investment projects and, possibly, short-term concessions on contract terms.
- Pubcos are likely to move pubs away from long-term agreements that carry a risk of lessees committing the company to a relationship including MRO for extended periods. Short-term tenancies and franchises are likely to be boosted, but long-term free-of-tie leases may also become more widespread.

We go on to review a selection of the larger quoted companies in the sector, taking into account where relevant the likely effects of MRO.

Enterprise Inns (ETI, 89p, market cap £442m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
09/14	632.0	121.0	302.0	19.0	0	4.7	9.0	0
09/15	625.0	122.0	296.0	19.4	0	4.6	9.2	0
09/16e	623.0	121.9	291.2	19.0	0	4.7	9.3	0
09/17e	638.8	119.7	284.0	19.1	0	4.7	9.5	0

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

As Enterprise Inns has 4,638 tied leases and tenancies (predominantly long-term assignable leases) out of a total trading estate of 4,977, it appears to be one of the more exposed companies to MRO.

However, over the last year strategy has moved fast, and in May 2015 the company had already announced a strategic programme through which it expects to diversify the estate into c 800 managed pubs and c 1,000 property assets by 2020. While the underlying purpose of the strategy is to maximise returns from each of the company's assets, this provides a dynamic context within which the MRO issue can be managed. It provides flexibility under which tenancy agreements may be enhanced (the company is introducing a new agreement in the second half of FY16), while tenancies exiting the tie could be administered as pure property assets with a commensurate reduction in cost to the company, which would then not deal with ordering, supply or area management.

Management sees the incidence of MRO taking effect over five years, as MRO events are largely expected to arise through the cycle of five-yearly rent reviews and agreement renewals. Though slightly dependent on the exact date that the Pubs Code takes effect, management's working assumption is that approximately 200 MRO trigger events will take place in FY16, and 600 such events per year thereafter. Management is preparing for the transition by taking a proactive approach with tenants. In addition, of the total, some 800 pubs are food-led, the beer tie does not represent material value, and a transition to a commercial property lease may in any case be more appropriate. Also, some 500 leases are expected to become available by assignment, where the choice of incoming tenant is subject to approval by the company.

Although the prospects for Enterprise do not imply growth, that is in any case not an objective. Rather, with the share price at a 68% discount to NAV, the company seeks to maximise returns from all its trading assets. Debt, once threatening, is now at a sensible level for a freehold based company, of 58% loan to value at March 2016, with the next substantial repayment being a 2018 bond repayment of £350m, which management expects to be able to refinance consistent with a current £25m share buyback programme. That also implies that the company does not intend to assign disproportionate cash to pub investment projects designed to incentivise existing tenants.

Enterprise trades at a low P/E ratio, reflecting its financing structure, but its EV/EBITDA multiple is mid-range for the peer group. It does not pay a dividend; it is currently distributing cash through its buyback programme.

Fuller Smith & Turner (FSTA, 975p, market cap £545m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
03/15	321.5	36.4	58.7	51.5	16.6	18.9	12.6	1.7
03/16	350.5	40.9	65.0	58.4	17.9	16.7	11.4	1.8
03/17e	370.0	42.1	67.6	59.5	19.0	16.4	10.9	1.9
03/18e	383.5	44.1	70.5	62.3	20.2	15.7	10.5	2.1

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

As Fuller's, with 203 leased and tenanted pubs out of a total estate of 398, falls below the 500 lower cut off for MRO, it is not directly affected. It could benefit indirectly on two counts. Firstly, on an increase in free trade customers (net of reductions in national accounts); and secondly on any increase in available pubs for purchase in its London and Southern England trading area, put onto the market by their pubco owners as a result of MRO decisions by their tenants. But these possibilities are too tentative to place any weight on at this stage.

In trading terms, the advantages of Fuller's locations in the still buoyant London market and more generally in the south of England, as well as the quality of the operation, continued to pay off in the year to March 2016. Like-for-like managed pub sales growth was 4.8%; this growth held up well for the second half against the interim 5.6%. The first 10 weeks of FY17, which preceded the Brexit vote, showed more muted like-for-like growth of 2.7%, described by management as "solid".

The premium valuation reflects the market's appreciation of the quality of Fuller's trading location, assets and management.

Greene King (GNK, 787p, market cap £2,433m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
04/15	1315.3	168.5	319.0	60.6	29.8	13.0	14.0	3.8
04/16	2073.0	256.5	496.9	69.9	32.1	11.3	9.0	4.1
04/17e	2236.0	287.2	539.2	73.2	33.9	10.8	8.3	4.3
04/18e	2287.0	304.4	552.8	77.5	35.9	10.2	8.1	4.6

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

With 1,147 tenanted and leased pubs, 38% of its total estate, Greene King might appear to have significant exposure to MRO. However, the company has guided to "expect minimal profit impact" from the legislation as it becomes operative over the next five years. Management has "sufficient optionality to mitigate the potential value transfer and sufficient time in which to put plans in place." Following the Commons vote there was "no change in our posture towards high quality tenanted assets" (average EBITDA from leased and tenanted pubs has risen from £57,500 in FY13 to £79,900 in FY16).

The prospectus for the May 2016 bond issue (whose scope was the Securitisation Group of 1,543 pubs) included comment that MRO "may have a negative impact (to the extent not mitigated) on the profitability of the Securitisation Group's tenanted and leased businesses… Potential mitigants… include entry into new agreements and continued work to maintain the already strong relationship between the Securitisation Group and its tenants".

Lying behind this is a history at Greene King of staying with short-term tenancy agreements with a culture of close control. This means that tenants are likely to be discouraged from exercising their MRO rights if they are seeking to renew their lease when it terminates.

Although operations also showed organic growth in FY16, the benefits of the £774m Spirit acquisition (June 2015) was a significant focus of the final results in July 2016. Management highlighted that of expected synergies of £35m, £18m was still to be realised, and that further returns were to be expected from investment linked to converting pubs from both companies into a set of 'drive' brands. Out of core capex guidance for FY17 of £130-140m (brand optimisation capex is an additional £40-50m), development capex is about a third, and guidance is for leased and tenanted disposals to be about 50-60. The medium-term target for the tenanted and leased estate is for a reduction to around 1,000 pubs, which may be expected through a combination of disposals and conversion to other trading formats such as franchising

As a major UK ale brewer, Greene King could benefit from an increase in its free trade account numbers, net of a loss of sales to the extent tenants exercise their MRO options and reductions in national account volumes.

An FY17e prospective P/E of 10.8x does not look stretched, the EV/EBITDA ratio of c 8x is mid-range for the sector and there is the additional attraction of a 4.3% yield.

Marston's (MARS, 138p, market cap £796m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
09/14	815.3	83.0	192.4	11.7	6.7	11.8	10.1	4.9
09/15	878.6	91.5	203.3	12.9	7.0	10.7	9.6	5.1
09/16e	909.4	98.1	214.2	13.7	7.3	10.1	9.1	5.3
09/17e	950.0	104.7	220.7	14.4	7.6	9.6	8.8	5.5

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

One-third of Marston's 1,570 pubs are managed and not subject to the MRO legislation. In relation to its leased and tenanted estate, having first introduced its franchise-style Retail Agreement in FY09, Marston's now has converted most of its remaining short-term tenancies to franchises under this and its successor format, the Pub Franchise. Management has guided to no significant impact. The effect in relation to its 339 longer-term leased pubs should be minimal since:

1. profits from leased pubs are only 15% of pub profits, and a smaller % of company profits;
2. at least half of that 15% is rent, which is not negatively affected by the MRO;
3. management regards its relationships with lessees as generally good, which is not universally the case across the sector; and
4. Marston's has had a 'free of tie' option available for many years which has had limited take-up, probably because lessees are generally cautious about increasing operational gearing by taking higher rents, even if there is an upside on drinks pricing.

Residual old-style tenancies now only account for around 100 pubs.

On the other hand, Marston's beer business has been at the centre of strategic focus for many years. Originally Wolverhampton & Dudley Breweries, the company added national brands such as Pedigree to its regional Banks's portfolio through the acquisition of Marston's in 1999 before changing its name to that of the target. Its largest selling brands today are Hobgoblin, Pedigree and Wainwright and it is actively marketing a range of smaller brands including serious craft beer brands such as Shipyard, the UK number three, to which it has the UK rights. From this perspective, management foresees a likely boost to its free trade customer numbers as a medium-term effect from MRO, net of reductions within national accounts.

In a strong first half to March, Marston's reported underlying pre-tax profit up 11.8% to £33.1m, and EPS up 11.9% to 4.9p. A highlight was the performance of the beer division, where the acquisition of Thwaites in March 2015 helped drive operating profit growth of 16%. But performance was also strong across the pub estate, with like-for-like growth of 3% across managed and franchised pubs, predominantly driven by food, and margin improvement of 10bps to 17.0% in the destination and Premium division, the largest of the managed pub operations.

Marston's is attractive for its high yield, and is carefully managed, with mainly organic growth driving double-digit growth in PBT and EPS in FY15 (although forecast growth is more modest).

Mitchells & Butlers (MAB, 243p, market cap £1,007m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
09/14	1,970.0	172.0	422.0	32.6	0	7.5	6.9	N/A
09/15	2,101.0	184.0	439.0	35.7	5.0	6.8	6.6	2.1
09/16e	2,109.0	187.9	442.9	36.2	7.6	6.7	6.5	3.1
09/17e	2,149.0	192.5	446.2	37.2	7.9	6.5	6.5	3.3

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

As it has no tenanted or leased pubs, Mitchells is not directly affected by the new legislation. Neither does it brew or sell drinks, so it will not be affected by any changes in buying patterns by tenants. The estate of 1,834 is almost exclusively managed, with a small number of franchises.

Mitchells is acknowledged to have a high-quality managed pub estate. But it has had a record of low earnings growth (although on a comparable basis EPS growth rose from 1.2% in FY14 to 9.5% in FY15) and until the FY15 final results did not pay a dividend, following events before and during the financial crisis that had left it with a significant debt burden. New CEO Phil Urban, appointed effective September 2015, has completed a strategic review and is focusing on building a more balanced business; instilling a more commercial culture; and increasing the pace of execution and innovation.

Despite earnings growth in H116 of 9%, success is not particularly recognised in the low forecast multiples. Loan to value on the £4.3bn property asset is 44%, and as well as the dividend, capex is being stepped up from £162m in both FY14 and FY15, to £200m in FY17.

Punch Taverns (PUB, 88p, market cap £194m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
08/14	448.1	68.6	204.8	181.5	0	N/A	N/A	N/A
08/15	420.8	60.9	196.4	25.0	0	N/A	N/A	N/A
08/16e	406.3	50.0	180.0	19.2	0	4.6	7.9	N/A
08/17e	402.5	58.0	175.0	21.9	0	4.0	8.1	N/A

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

Punch Taverns signalled in its FY15 results that if lessees invoked the MRO option, while the loss of tied drinks income would be partially offset by increases in rent, total income could be adversely affected. Out of net income of £248m, £134m (54%) was from drinks, of which £72m (29%) was from core pubs with future potential for an MRO event trigger to occur. However, the company's expectations were that the majority of the estate will continue to operate under the tied model.

The company has taken a number of actions in anticipation of the MRO legislation. It created a Retail Division, marking a strategic move away from long leases to short-term tenancy agreements, and, separately, creating a commercial free-of-tie lease division.

Although 56% of the estate (some 1,860 pubs) is currently let under long-term leases, management expects the make-up of the estate to change significantly over the next few years as these are replaced by short-term agreements and its new retail agreements, which are proving very popular with licensees. Management points out that only 7% of its core estate (around 180 pubs) has more than five years remaining at the next rent event, which means that management has the ability to actively manage the estate away from long-term leases in the relatively near term. This therefore means that the company should not be materially committed over the medium term to agreements where the tenant may opt for their MRO rights.

Capex in FY15 was reduced 12% to £46m in the face of the uncertainty, but guidance is for FY16 and future spend to be at earlier levels of £50-60m, which may include an intention to use the investment exemption provided by the legislation in some cases.

Punch's core estate of 2,591 pubs reported like-for-like net income growth of 1.6% at interim (its original non-core estate of 499 lower-profitability pubs was in growth at the EBIDTA level). It is growing its Retail Division, and developing franchise-style retail agreements, although unlike Enterprise it is not venturing into direct pub management. Its net debt is at 59% loan to value, and under its securitisations annual repayments are not burdensome, at between £31m and £41m pa until 2020.

A low P/E ratio reflects its debt structure, although this was redefined from higher historical levels in a debt:equity swap in FY14. Prospective EV/EBITDA is slightly lower than the peer group average. Punch does not pay a dividend.

Shepherd Neame (SHEP, 1,175p, market cap £174m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
06/14	138.7	8.8	20.5	48.5	25.9	24.2	11.5	2.2
06/15	138.3	9.6	21.0	50.3	26.7	23.4	11.2	2.3
06/16e	142.0	9.6	21.0	49.9	27.5	23.5	11.2	2.3
06/17e	145.0	10.0	21.5	52.2	28.3	22.5	10.9	2.4

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis. All results and forecasts are on a GAAP basis, but FY15 onwards will be restated for FRS 102. The effect of restating FY15 is a c 3% reduction in PBT and EPS.

Even though Shepherd Neame's estate totalling 335 pubs is predominantly tenanted (269: there are a further seven on free of tie leases), it is well below the 500 leased and tenanted threshold for the MRO legislation. Its brewing operations, whose main products are Spitfire, Bishops Finger and the Whitstable Bay ranges, could arguably benefit from increased free trade business, net of any reductions on national accounts.

The company's trading heartland is in Kent, although it has a minority of pubs in London. The South East England economy, with total GVA growth of 16.6%, was second only to London (24.0%) in the period 2010-14 (source: House of Commons Library, March 2016). Shepherd Neame has delivered steady earnings growth of around 5% on average over the last five years. This is supported by consistent investment in expansion and development of the estate.

The shares, quoted on the ISDX market, are priced to reflect the steady performance, South of England locations and relatively low geared freehold-backed balance sheet (loan to value was only 22% at December 2015).

JD Wetherspoon (JDW, 802p, market cap £911m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
07/14	1409.3	79.4	171.5	48.5	12.0	16.5	9.0	1.5
07/15	1513.3	77.8	174.0	48.6	12.0	16.5	8.8	1.5
07/16e	1590.0	76.3	176.2	44.8	12.1	17.9	8.7	1.5
07/17e	1648.0	79.9	181.0	49.8	12.3	16.1	8.5	1.5

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

JD Wetherspoon is the most homogeneous of all pubcos in that is entirely managed and effectively has a single brand. As a result it is not directly affected by the MRO legislation.

Indirectly, though, its large pubs have historically gained share in local markets by competing on price against tenancies tied into highly priced beer by their pub companies.

In this sense, the advent of MRO could be a negative, although that argument does not take account of the fact that the situation has relaxed more recently, particularly through the adoption of franchise-type agreements by former tenancy owners, where the pub company now controls the retail price of drinks; and the fact that tenants who exercise their MRO rights will effectively be trading on their own, without the benefit of operational and marketing support that they would have had from their pub companies.

Earnings growth has been limited over the last few years (4.4% over the last three years, although a pick-up is forecast). Managed operating margins are low for the sector and have declined from 10.0% in FY10 to 6.3% in H116. Nevertheless, the company computes post-tax cash return on cash capital employed (CROCCE) at 14.0%, well in excess of the weighted average cost of capital (WACC) of 3.2% (source: Bloomberg). With 50% of the pubs held on leaseholds, fixed charge cover is a key measure of debt exposure. This stood at 1.7x at H116.

The shares are priced on a relatively high P/E ratio, although this reflects the partial leasehold and debt structure. On an EV/EBITDA basis they are comparable with the peer group average.

Chairman Tim Martin owns 29.5% of the shares and has been outspoken on issues such as VAT equality (for), Brexit (for) and the Corporate Governance Code (against).

Young & Co (YNGA, 1,214p, market cap £535m)

Year end	Revenue (£m)	PBT (£m)	EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
03/15	227.0	32.0	52.2	50.6	16.5	24.0	12.7	1.4
03/16	245.9	35.4	58.4	57.2	17.5	21.2	11.4	1.4
03/17e	262.5	39.1	64.7	63.7	17.4	19.1	10.3	1.4
03/18e	272.0	40.5	66.4	65.7	17.9	18.5	10.0	1.5

Source: Company, Bloomberg. Note: PBT, EBITDA, EPS are on an adjusted basis.

Young's, with only 80 tenancies, is far below the MRO threshold, and does not brew its beer, after selling the Wandsworth brewery in 2006 to finance investment in pubs. Managed houses, which contribute 94% of operating profit before central costs, are well-invested and target the premium end of the pub market. With its focus on the London economy, like-for-like sales growth has been consistently ahead of the sector generally (5.6% for the year to March 2016, 5.3% in seven weeks' post-year end trading), and earnings growth has been steady. Loan to value at March 2016 was a conservative 20%. The strength of both trading and the balance sheet, as well as management's track record, is reflected in the share price.

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