Whitbread Group: Proposed Sale of Costa

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Presentation

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Welcome

Good morning everyone and thanks for dialling in to hear more details about Whitbread's proposed sale of Costa Coffee to The Coca-Cola Company. I am joined by our Group Finance Director, Nicholas Cadbury. We have provided a short presentation to support this morning's discussion.

Summary of Proposed Sale of Costa to The Coca-Cola Company

Benefits all stakeholders

We are going to start on slide 2. The Whitbread Board and I are excited to announce this very attractive transaction that has a value of £3.9 billion, which the Board unanimously agree is in the best interests of all of our stakeholders.

Recognises strategic value of Costa brand

This value recognises the strategic value of Costa's brand strength, multi-channel presence and international growth potential. The transaction allows Whitbread shareholders to realise an attractive cash value upfront, representing an enterprise valuation multiple of 16.4x Costa's 2018 financial year EBITDA.

Not only is the valuation compelling in its own right, as it is significantly higher than currently reflected for Costa in Whitbread's market value, but it also represents a substantial premium to the value that would have been created through the previously announced demerger. The realisation of this value will be enabled through Coca-Cola's synergies in product development, distribution, marketing and vending.

Majority of proceeds to shareholders

A significant majority of the net cash proceeds are intended to be returned to shareholders, with proceeds also used to reduce the pension deficit and financial indebtedness, which will provide headroom for further expansion of Premier Inn both in the UK and in Germany.

Value and Transition

Significant premium to previous demerger plan

If you turn to slide 3, the transaction provides shareholders with a compelling valuation of Costa. The value is both significantly higher than in the share price and a premium to the previous plan to demerge Costa. The transaction recognises the strategic valuation of Costa's brand strength, together with its multi-channel capabilities and international growth potential. Coca-Cola's strength in product development, marketing and distribution will be able to support Costa in realising this international potential beyond that which could possibly have been achieved by Costa as an independent listed entity.

Supporting a smooth transition

Once the transaction has been completed, Whitbread will support Costa and Coca-Cola to ensure a smooth transition process through a transitional services agreement, which is expected to last between 12 and 24 months. That includes the provision of IT, procurement and logistics, supply chain and HR services.

As we work through the separation, we will incur some restructuring costs and some incremental central costs. We will provide you with an update on those in due course.

Timeline and Proceeds

Completion expected in first half of 2019

Turning to slide 4, we expect the transaction to be completed in the first half of 2019. We will be distributing a shareholders circular shortly with the aim of holding a General Meeting in October. In addition to shareholder approval, the transaction requires regulatory approval in both the EU and in China. At the time of completion, Whitbread will receive the total consideration for the transaction.

Use of proceeds

The exact route to return these proceeds will be considered at completion. However, as previously stated, a significant majority will be returned to shareholders. We will also make a contribution to our pension scheme and reduce our other financial debt.

We plan to host a Capital Markets Day in early 2019 to update on our strategic progress and share more information on the future plans of Whitbread.

Enhanced Focus on Premier Inn in UK and Germany

UK's leading hotel chain

Finally, turning to slide 5, along with the initial cash generation from the proposed sale of Costa, the transaction will also provide Whitbread with an increased focus on Premier Inn and its substantial growth potential in the UK and Germany. With over 72,000 rooms in the UK and significant structural and competitive advantages, Premier Inn is already a highly successful business and the UK's leading hotel chain by a considerable margin. With increased focus and financial resources, we will continue to leverage our advantages across digital distribution, property and product innovation to widen the gap between Premier Inn and its competitors.

Accelerate new network in German market

We will not only achieve our 85,000-room target in the UK by 2020 at strong returns above 13%, but will also utilise these strengths as we start to accelerate the development of our new network in the very attractive German market. Premier Inn already have a good pipeline of 32 hotels in Germany, and our increasing visibility and activity in the property market, along with that fragmented competitive set gives us great confidence that we can replicate our success in the UK, both in terms of network scale over time and the level of returns achieved.

Thanks very much for listening to the summary, and Nicholas and I will be very pleased now to answer any questions you may have.

Q&A

Jarrod Castle (UBS): Three, if I may. Firstly, a very good multiple achieved for the business, but can you give any colour if there were any other interested parties?

Question two on Pure, does it still make sense to have that interest within the Company, and do you have any kind of plan in terms of what you will do with that business?

Lastly, you talk about substantial cash returns. I know it is still early stages, but what does 'substantial' mean in terms of potential returns, and what potentially could you do with any remaining cash?

Alison Brittain: In terms of your first question, we obviously announced that we would demerge the businesses at our results presentation in April. Of course, Costa is a wonderful business, and therefore there are people with interest in the business. We have been very clear that we would not enter into a sale unless it was a strategic opportunity for the Company; that it would be great for Costa in its future development, great for Whitbread in terms of the returns that we received, great for shareholders in terms of the value that would accrue. It was when the Coca-Cola opportunity emerged, and we started some discussions with them, that we could really see how the complementary nature of the Costa business and the Coca-Cola business would mean a significantly higher value could be created in the future, which would allow Coca-Cola to pay an increased price. That opportunity was one we were very interested in and pursued. That is probably all I need to say on question one.

Pure is great, it is a really nice business. We bought 49% of it, and we have allowed the owners a very free rein to keep running it; it was part of the deal for us to have their enthusiasm, commitment and expertise. They are doing well at growing that business, and I still think it is lovely.

Whitbread has a long history of taking on upstart businesses, growing them and then divesting them. That is something we have done many times. Of course, Costa is a fantastic success story in that regard, having been bought 20 years ago for £19 million when there were only 39 shops. So, I think Pure is a great opportunity. We are giving it another two years to mature and grow under its current leadership, and then we will make a decision at that stage as to what we think its potential is.

Nicholas, Would you like to talk about the fact that we probably will not tell anybody what the number is, just the potential return to shareholders?

Nicholas Cadbury (Finance Director, Whitbread Group plc): What we released in the RNS is what we are going to say again. We have done the deal at a tremendous pace, so we set time to make sure we got reflection going forwards but we will return a significant majority back to our shareholders.

The other thing that we need to take into consideration is we do need to reach an agreement with our Pension Trustees. We have a pension deficit of about £350 million, so it would be a good thing to see if we can address some of that; all which will also, in turn, reduce some of the volatility in the capital structure of the Company, so it will be good for Whitbread as well.

There is also the opportunity to deleverage over the short to medium term. On the deleveraging, we are very comfortable to maintain our leverage guidance at below 3.5x. This allows us to deleverage over the short to medium term, which allows us some more firepower to go faster and accelerate on investments in the UK and in Germany on Premier Inn.

However, those are things that we will need to think about over the next few months, and of course we will be consulting with our Pension Trustees and also our debt holders, and also gathering our views from our shareholders as well. That is probably all we can say at the moment.

Tim Ramskill (Credit Suisse): Three questions from me. Nicholas started talking there about thoughts on leverage etc. To be very clear on this, effectively you are just wanting to keep a little bit more firepower. To help us understand that, did you feel that in any way as things stood previously, you were a little capital-constrained in terms of what you might have been able to do, particularly with Germany?

We can debate it but ultimately, clearly activist shareholders have been involved over recent months, and one of the longstanding attributes of Whitbread as a business has been the real estate, the freehold asset-backing. The equity market is not necessarily always brilliant at reflecting asset value, so I wondered whether you had updated on your thoughts as to whether there is anything to do within Premier Inn around the asset base.

Alison Brittain: No, I do not think we felt at all capital-constrained. We self-impose our constraints; we are very focused on return on capital, and we set high hurdles for projects against those thresholds. We did an acquisition in Germany which has not yet completed, but the issue in Germany is that there are not huge numbers of opportunities, and some of them are quite small when they do come. You could say the one we acquired was small at 20 hotels, and so we have not felt that we have not been able to execute.

Equally, we would like to expand our network in Germany and potentially accelerate. We will continue looking for opportunities, but we are quite happy to keep a lower leverage until we find the right opportunities. We are not going to compromise the quality of our returns at the expense of that.

So no, I do not think we felt particularly constrained because we use our capital hurdles to make sure we only take the very best properties, and we discard huge numbers of deals every month that we think are not good enough. That is not because we have not got any capital; it is because we do not think that the quality of the deal is good enough.

You asked about asset management. We are always pretty happy with our position. We like having our freehold backing. We have very good rationale for why we think it helps us generate huge profitability and direct distribution in the Premier Inn business.

Clearly as a result of everything that is going on in terms of the transaction, we will end up having to sort out our finances, transitional arrangements, cost structures and everything. We think that the best route to talking to the market about that is to hold a Capital Markets Day for the Whitbread and Premier Inn business probably early into the very start of next year. We can then discuss all the issues that you are raising. The last eight weeks have been pretty intense.

Tim Ramskill: Can I just follow up? The way I like to think about it, particularly in the London market, is if you have real estate where there is a potential 4% yield that you could achieve, that is therefore an asset effectively in your return of 4%, which is not huge. Would you fundamentally disagree with that observation? Is that the wrong way to think about it?

Nicholas Cadbury: I think we are going to address that through the interim and the Capital Markets Day if you want to go into more detail.

Alison Brittain: Yes, I suspect we probably have a lot more questions and some on the immediacy of the deal. Would you mind if we picked that up later? Let us deal with today's news.

Jaafar Mestari (Exane BNP Paribas): I have two questions. The first one is you had set £100 million cost efficiency targets for the Group that was left to deliver. How much of that do you estimate at the moment is deliverable by Premier Inn on a standalone basis?

Within that, there are different parts. Will you maybe have to dial down some of the joint procurement benefits now there is one company and one hotel company?

My second question is on property value. How much of your estimated property value will be effectively sold with Costa? I am thinking about the old coffee roastery, the new roastery, maybe some of the large Drive Thru properties for Costa.Does the sale of Costa move your estimated £4.2 billion to £5.1 billion property value?

Alison Brittain: No, not really. I think you will find it would be lost in the rounding. The transfer is £38 million out of our £45 billion of property assets; it is only the roastery. The rest of the Costa business is largely leasehold, so there is not a dilution of our freehold covenant at all.

On the cost efficiencies, we knew we were planning to demerge so we have been managing our contracts to be appropriate for a demerged business and a split. We have been using our firepower to get good discounts, but we have been making sure that we can run separate contracts. Also, we had the bulk of our £100 million in the first year. Obviously, we will likely see this year out as an entity with Costa in it, because its likely completion would be into 2019 and at the end of the financial year.

So, we are not uncomfortable with our targets. We have always had separate targets for Premier Inn and Costa. We do not really have an efficiency issue here, and Premier Inn and Whitbread have a long route to further efficiencies in future years, so we are not worried about that. However, we will have a few stranded costs and some disynergies, which we will deal with and talk about at our next set of results.

Nicholas Cadbury: You will have one-off costs in restructuring. Then you will have some costs once we are running TSAs for the 'remain co' for a period of time between nine months and two years, and then as we go through and redevelop the transition to the remaining Whitbread.

Alison Brittain: Yes, we will give some more colour on that at the next results presentation.

Jamie Rollo (Morgan Stanley): A couple of questions. Back on the deleverage figure, I think you ended FY18 at 2.8x, and on my numbers that would have gone up 3.2x for the hotel business post the demerger. Is the reference to deleveraging to go below what would have been a higher multiple, or to below the 2.8x you ended the year at? If you could give us some sort of feeling whether it is nearer 2 or nearer 2.5x, that would be quite helpful.

Secondly, back on Germany, what happens if in an unnamed large German hotel deal does come along in the next six months? What takes priority, that or the majority return of cash?

Nicholas Cadbury: In terms of the leverage, at the year end we were 2.8x. I think we flagged that the reason we have gone down to 2.8x is we still had the German acquisition to pay for which comes up in 2020, which would have taken us back up to low 3.0s. That is where we continue to be comfortable.

This will give us an opportunity to deleverage. Again, we are not going to be drawn in terms of where that is going to be, though it will not be as low as 2x overall. As we said, it is an opportunity to reduce some of the volatility by addressing the pension fund as well. We have some of our short-term debt which comes up over the next year as well, which we will have a look at.

Alison Brittain: You asked a follow-up question around returns to shareholders. We are intending to return the significant majority to shareholders. We think that we will be able to manage what we need to do, or what we would like do in terms of our network expansion through the remaining part of the business without too much difficulty. We are not anticipating that being an issue – the one that you have raised. I will not say anymore than that at this stage; it would be speculative to say anything more.

Jamie Rollo: Back on the cash return, a significant majority is clearly a wide range, but is it fair to say it will not be more than £3 billion if you have seen a modest amount of deleverage?

Nicholas Cadbury: We are not going to get drawn on that. All I will guide you to is if you think about the size of our pension deficit overall; look at maybe some of the short-term debt that is coming up for renewal; then think about also in terms of the price we need to pay for our German acquisition as well, which is about £300 million overall. Put those three together, and it gives you a fair indication.

Lena Thakkar (HSBC): In terms of the shape of the business post this transaction, obviously it will be very streamlined. Do you feel that there is any scope at all to venture out into new businesses or new geographies with your current hotel business, or are you keen to stick to the UK and Germany?

Secondly, I think you sort of touched on some synergies/disynergies, but will there be any small impact on Premier Inn revenues, or how are the Costa revenues within that business recorded from shops, machines or is it immaterial?

Then on the cash return, do you have a preference for special ‘divvies’ or buybacks? Should we think there will be any change in the ongoing dividend policy post the transaction?

Alison Brittain: Yes, good questions and as I said before, Whitbread has had this great history over a long period of time of acquiring businesses, growing them, developing them and then selling them and creating value. So, we are not without skills in that area and clearly we have a clear plan and focus in our Premier Inn and restaurants business.

We also have a half-stake in Pure, which is a nice business. It willprobably, in the next 18 months,become the size of Costa was when Whitbread acquired Costa.It will be something around 30 stores and probably not a dissimilar price. That is interesting in itself and, of course, you never-say-never. However, it is not the focus of our attention and it is not the focus of the use of the sales proceeds.

In terms of use of sales proceeds, we all know what the obvious mechanisms are to return sale proceeds. We have not made any definitive decisions on what quantum in each or which. Of course our shareholders, who we will be seeing pretty much all of over the course of the next few weeks, will undoubtedly share their views with us. It is not a consultation, but we will be listening. Then the Board will make some decisions about the best mechanism in their view, and we will announce that.

Nicholas Cadbury: You also asked about Costa stores and the Costa Express proceeds in Premier Inn. I just think that it is a small amount. We have quite a few Costas in there and Expresses, but most of them we have arm's length contracts with.

Lena Thakkar: Then the ongoing dividend policy?

Nicholas Cadbury: That is one of the reasons we have the Capital Markets Day in early next year.

Alison Brittain: We will cover all of that – capital planning and dividend policy – at that meeting.

Patrick Coffey (Barclays): Two questions. Given the returns profile of Premier Inn, would it not create more balance to shareholders if you used a significant majority of the capital, received from the Costa sale, to accelerate the Premier Inn rollout both in the UK and internationally, rather than return a substantial amount of around £3 billion or whatever it is back to shareholders?

Secondly, obviously huge significant news today but no news on current trading. Do we take that to mean that underlying current trading has not changed since you last updated?

Alison Brittain: I think you can take it to mean that we just had an absolutely stonking deal that we needed to announce this morning. We signed it at 06.52 this morning and announced it eight minutes later. We have a trading update in October as part of our half-year results presentation, and I do not think we will be talking before that; there is no need for us to talk about that.

I like your long-term thinking. I wish more had your long-term thinking, because we think this is a deal which allows for all good things to come through. It allows us to reward shareholders for their investment in Costa, it allows us to add firepower for significant growth in our business and Premier Inn both in the UK and Germany, and to ensure that our pensioners are in a safer place. We just think it does all things and that we will have enough firepower left to grow sensibly at proper returns, holding the line on our sensible capital management policy. I agree with you that what we are aiming for is that growth, and I think we can achieve it and still return shareholder proceeds.

Sophie Aldrich (Aberdeen Standard): I had a question regarding your funding plans for expansion and acquisitions for Premier Inn as a business by itself, whether this is predominantly going to be funded by proceeds from the Costa sale or majority debt finance.

Nicholas Cadbury: I guess a mixture of both. As I mentioned earlier, we work to a leverage target overall and we are comfortable with maintaining that leverage at below 3.5x. We will manage within that ratio. We will get some support on that through the sale of Costa. However, we will assess that from time to time in terms of the balance between returning that to shareholders if there are not opportunities going forward, or if there are opportunities, to invest in the Company, so we will probably just leave it there.

Monique Pollard (Citigroup): A couple from me. Firstly in terms of the pension, obviously we know the size of the pension deficit. I guess negotiations start with the trustees, but is it reasonable to assume from comments that Nick made earlier, that largely gets paid down with the proceeds of the sale?

The second question: when we think of the business post the sale of Costa, excluding the Pure business that you have a stake in, you are a single brand then – a hotel with good scale in a particular space that a lot of the other larger global hotel companies do not operate in. Do you think there is potential that you could be having discussions with some of the other global brands about the business post Costa sale?

Nicholas Cadbury: The first question on pensions, we have a deficit of around about £350 million. I am not going to quantify how much of that we are going to look to address at the moment. However, we are going to have reasonable conversations with our Pension Trustees, who we have a good relationship with.

Alison Brittain: On the other question, I will go backwards a bit. One of the reasons we were going to demerge Costa and split the two businesses was because they are quite different in their makeup, and we know that we have investors for our hotel business who are very keen on several things about it: 1) its unique business model; 2) the structural growth available into markets, the significant scale and direct distribution that has been achieved in the UK – we have still runway to go; and I guess the ability to potentially replicate that over the next 20 years in Germany, at good solid compounding returns.

We expect that we will want to continue that and we have further innovation in the UK. We have the 'hub' brand now, we have other innovations that are in the pipeline that will expand our network potential in the UK, and we have the whole of Germany as a sort of greenfield to be going at. We are really comfortable that we have a unique business model in the world. It is unique, but highly effective, highly profitable and delivers compounding long-term returns to shareholders. So, we are not anticipating anything other than continuing on that path.

Thanks everybody for dialling in today. As I said at the start, I think this has been a great transaction for Whitbread, for Premier Inn, for Costa, for our teams and all of our stakeholders. Thanks very much for dialling in and sharing the good news with us this morning. Have a great day.

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