



Punch Taverns Ltd

Ticker: PUNTAV

Isin	Issue Size	Rating	Coupon	Min piece	Maturity	Offer	YTM	Spread
XS1114385955	£72.9m	Unrated	7.75%*	£1k	30 th Dec 2025	101.5	7.56%	634bps

** Coupon is deferrable, cumulative, with interest paid on interest*

Introduction

Punch Taverns 7.75% subordinate note is a small, but high yielding security within the Punch Taverns whole business securitisation.

Since the group’s restructuring in late 2014, which saw net debt reduce by circa £200m, credit fundamentals have steadily improved. Gross profit per pub has risen from £64.6k per year to £69.3k over the past three years.

Net debt has also steadily declined from £573m in August 2015 to £474m in March 2018; this has driven an improvement in the Leverage ratio from 3.06x to 1.94x.

Recently acquired by Patron Capital, a pan-European private equity group, we anticipate the group may seek to term out its debt in due course. In the meantime, the group’s B notes provide a 7.56% ytm (+634bps); an attractive running yield of 7.64%.

The securitisation is underpinned by net equity of £273m at March 2018. With ongoing free cash flows committed to debt amortisation, we anticipate further improvement to the structure’s credit metrics in the full year figures.

About the group

Patron Capital completed its acquisition of Punch Taverns in August 2017. Although the overall group owned around 3200 pubs, circa 1900 sites have been sold onto Heineken, leaving Punch Taverns with around 1300 pubs. The portfolio is steadily contracting, as Patron (following on from previous ownership) continues the process of selling non-core sites, or converting establishments to other uses. In the March 2018 (Q2) bondholder report, there are 1253 pubs, of which 162 are now classified as non-core (reduced from 330 at August 2015).

Punch Taverns is entirely funded by a securitisation structure, with four bonds outstanding. The three A class notes (not a credit rating to be clear) have a first ranking fixed charge over shares in Punch Taverns (PMH)

Limited. The junior B notes have a first ranking fixed charge over the assets and undertaking of Punch Taverns Holdco (B) Limited (new holdco 2 – see Appendix 1).

The A class notes have commenced amortisation, meaning that nominal amounts outstanding are steadily declining. As at 3rd March 2018, remaining amounts are as follows. I have highlighted the position from 12 months before, to highlight the attrition rate:-

Debt £m	3 rd March 2018	3 rd March 2017
Swap loan	-	8.7
A3 (7.369%)	107.3	114.3
A6 (5.943%)	211.5	218
A7 (5.267%)	137.4	138.7
B3 (7.75%)	72.9	72.9
Gross debt	529.1	552.6
Cash	54.6	32.4
Net debt	474.5	520.2

Recent developments in the UK

The Business, Enterprise and Employment Act 2015, came into effect on 21st July 2016. The legislation enables some lessees to opt out of the drinks supply tie at certain points during the term of the lease agreement, and occupy the premises on a standard commercial lease, paying rent only. In response to the legislation, Punch, as well as other large Pub groups in the UK, are in the process of altering the business mix within their respective estates. More pubs are being managed centrally, bespoke deals are being offered to lessees to encourage a rollover into new “tie-in” arrangements (drink and rent); and where deemed appropriate, a site is converted for alternative use, or sold.

About the portfolio

Punch’s portfolio is predominantly held on a freehold basis, with a small number of leasehold pubs. The portfolio is held within a series of subsidiary entities, defined as obligors in the 2014 prospectus (the most recent restructuring). The group commissions an open market valuation of the properties on a five-year rolling basis by qualified external valuers, in accordance with RICS Valuation Standards.

As at 3rd March 2018, the Punch securitisation valued its fixed assets at a £771.5m. A further £54.6m is held in cash. The overall securitisation includes a number of covenants that are tested at each quarter-end. The covenant, as well as the result of the most recent tests, are outlined below:-

EBITDA to interest – not less than 1.4x, increasing to 1.7x by August 2022

March 3rd 2018 – 1.9x (€66.2m EBITDA versus £34.4m Interest)

Free Cash Flow to Debt Service – not less than 1x

March 3rd 2018 – 1.6x (€82.7m FCF versus £50.9m Debt service, including principal repayments)

Net Senior Debt to EBITDA – not greater than 6.7x tightening to 6x in December of this year

March 3rd 2018 – 6.1x (€66.2m EBITDA versus £401.6m Net Senior Debt)

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In the year to August 2017, the securitisation generated a gross profit of £89.2m, of which £41.6m was derived from drinks, £35.6m from rents, £3.8m from slot machines, and £8.2m from “other”. After operating costs totalling £20.3m, and cash interest charges of £35.1m, the group generated a profit before tax of £27.2m. This compares with a £22.1m profit in the previous year.

Key items (£m)	H1 to March 3rd 2018	H1 to March 3rd 2017	FY to August 19th 2017	FY to August 19th 2016	FY to August 19th 2015	FY to August 19th 2014
Turnover	78.7	79.1	153.8	154	160.4	-
Drinks	20.1	20.9	41.6	43.6	43.8	-
Rent	19.2	19.1	35.6	33.6	37.4	-
Machines	1.9	2	3.8	3.6	3.9	-
Other	3.9	4.1	8.2	8.8	8.8	-
Total gross profit	45.1	46.1	89.2	89.6	93.9	-
Op costs	-11.6	-10	-20.3	-21.1	-22.9	-
EBITDA	33.5	36.1	68.9	68.5	71	-
Property related profits (Sale proceeds in excess of book value)	8.5	2.5	4.3	6.2	-0.1	-
Cash interest	-18.4	-19.1	-35.1	-36.5	-40.3	-
Profit before taxation	20.1	15.4	27.2	22.1	34.2	-
Spend on Pubs	-6.7	-14.2	-29.9	-26.3	-16.1	-
Pub disposals	27.4	7.3	15.5	41.2	27.9	-
Net proceeds	20.7	-6.9	-14.4	14.9	11.8	-
Number of Pubs (core)	1,091	1,110	1,110	1,115	1,123	1,142
Number of Pubs (non-core)	162	199	177	214	330	409
Total	1,253	1,309	1,287	1,329	1,453	1,551
Gross debt	529.1	552.6	537	565.6	608.1	833.8
Cash	54.6	32.4	31.8	37.3	34.8	72.3
Net debt	474.5	520.2	505.2	528.3	573.3	761.5
Shareholders' funds	272.6	242.5	255.4	224.2	198.5	-19.9
Leverage ratio (debt/equity)	1.94	2.28	2.10	2.52	3.06	
Free cash Flow (EBITDA + Net pub disposals) rolling 4 quarters	82.7	60.8	67.2	83.7	83.2	-
Interest Charges	34.4	35.7	34.9	36.5	37.7	-
Repayments of Principal	16.5	25.1	24.5	25.5	27.4	-
Earnings per pub £ (gross margin/ No of pubs)	35,994	35,218	69,308	67,419	64,625	-

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Comment

Following the expiry of a 2-year non-call period in October 2016, the group has the option to refinance the B Notes with new subordinated debt, or via an equity injection, at not less than five business days' notice.

Despite the existence of the relevant clause in the prospectus, the group has so far opted to leave the security outstanding. One explanation is that issuance costs relating to a new deal may nullify any potential gains to be achieved from refinancing with a lower coupon instrument.

But we also think a restructuring would likely encompass the three "senior" A class notes. Those instruments can be redeemed in full early, but only by triggering a Spens Clause (ref gilts +100 basis points); consequently, a tender / exchange for some or all the deals seems more likely.

With £90.1m of A3 notes scheduled to mature in September 2021, and a further £190.3m of the A6 notes in September 2022, we think the group may look to refinance all outstanding debt prior to the 2021 redemption (see Amortisation Schedule in Appendix 2). A refinancing could potentially cut finance charges, as well as providing Punch will a longer time frame in which to drive higher returns from its core pub portfolio.

At 101.5, the group's B notes offer a 7.56% yield to maturity – gilts plus 634 basis points. The potential return compares favourably with 5.267% A class notes maturing in March 2024, which yield 3.4% to the weighted average life.

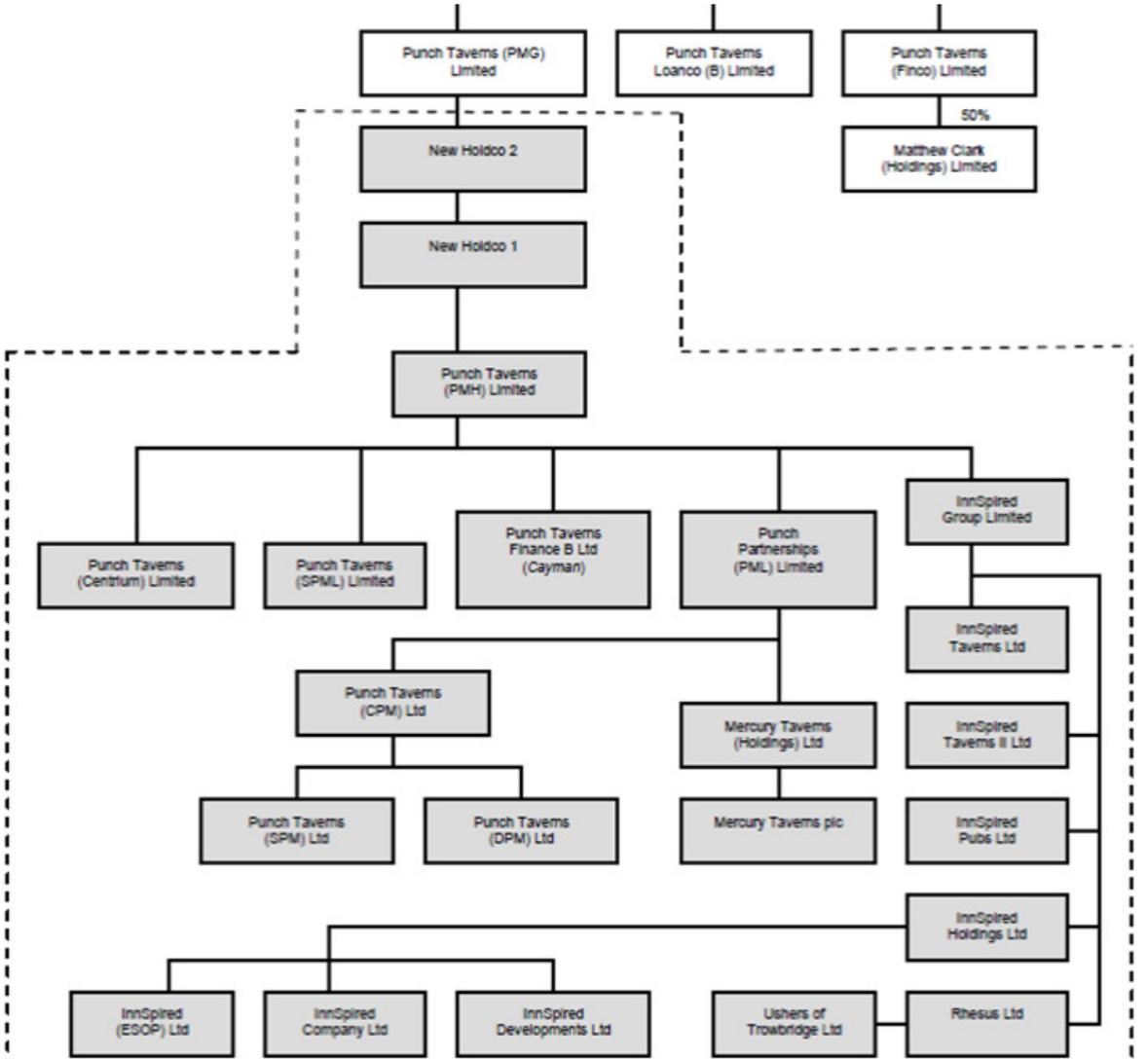
While the A notes benefit from security over Punch Taverns (PMH) – an entity which is structurally closer to the underlying estate (see group structure in Appendix 1), the whole securitisation is meeting its covenants as outlined above. And as at 3rd March 2018, the group posted £273m of net equity within the structure.

A restructuring is likely to follow in our opinion. But at 101.5, investors would break even if the note remains outstanding until 21st August (a hold period of two and a half months). If Punch seeks to restructure the deal in 24 months' time, bond holders will have received a 7% return.

Please call the desk if you have any enquires.

Rupert Marcus

Appendix 1



Appendix 2

DEBT AND AMORTISATION SCHEDULES

PUNCH B AMORTISATION

	SCHEDULED	SCHEDULED	SCHEDULED	SCHEDULED	SCHEDULED	SCHEDULED
Interest payment		Amortisation amount £'000				
date falling in :	Hedge loan	Class A3	Class A6	Class A7	Class B3	TOTAL
30 December 2014	1,910	-	-	-	-	1,910
30 March 2015	1,910	4,526	-	211	-	6,647
30 June 2015	1,910	4,526	-	211	-	6,647
30 September 2015	1,910	4,526	-	211	-	6,647
30 December 2015	1,910	4,526	-	211	-	6,647
30 March 2016	1,910	4,158	-	211	-	6,279
30 June 2016	1,910	4,158	-	211	-	6,279
30 September 2016	1,910	4,158	-	211	-	6,279
30 December 2016	1,910	2,013	2,024	323	-	6,270
30 March 2017	1,910	2,013	2,024	323	-	6,270
30 June 2017	1,910	2,013	2,024	323	-	6,270
30 September 2017	1,764	1,557	2,024	323	-	5,668
30 December 2017	-	1,499	440	323	-	2,262
30 March 2018	-	1,499	440	323	-	2,262
30 June 2018	-	1,499	440	323	-	2,262
30 September 2018	-	1,499	440	323	-	2,262
30 December 2018	-	1,220	440	323	-	1,983
30 March 2019	-	1,220	440	323	-	1,983
30 June 2019	-	544	440	323	-	1,307
30 September 2019	-	661	880	323	-	1,864
30 December 2019	-	735	880	323	-	1,938
30 March 2020	-	882	1,100	352	-	2,334
30 June 2020	-	882	1,100	352	-	2,334
30 September 2020	-	1,616	1,100	352	-	3,068
30 December 2020	-	1,616	1,100	352	-	3,068
30 March 2021	-	1,616	1,100	352	-	3,068
30 June 2021	-	1,616	1,100	352	-	3,068
30 September 2021	-	90,155	2,200	702	-	93,057
30 December 2021	-	-	2,640	702	-	3,342
30 March 2022	-	-	2,640	3,162	-	5,802
30 June 2022	-	-	2,640	3,162	-	5,802
30 September 2022	-	-	190,344	3,513	-	193,857
30 December 2022	-	-	-	5,621	-	5,621
30 March 2023	-	-	-	5,621	-	5,621
30 June 2023	-	-	-	4,215	-	4,215
30 September 2023	-	-	-	5,621	-	5,621
30 December 2023	-	-	-	9,836	-	9,836
30 March 2024	-	-	-	90,577	-	90,577
30 June 2024	-	-	-	-	-	-
30 September 2024	-	-	-	-	-	-
30 December 2024	-	-	-	-	-	-
30 March 2025	-	-	-	-	-	-
30 June 2025	-	-	-	-	-	-
30 September 2025	-	-	-	-	-	-
30 December 2025	-	-	-	-	72,911	72,911

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