

BUSINESS REVIEW

Overview of results for the 53 weeks to 4 October 2008

Turnover increased by 2.0% to £666.1 million (2007: £652.8 million). Underlying operating profit of £161.6 million was 1.0% below last year (2007: £163.2 million). Profit before taxation and exceptional items was £85.1 million (2007: £98.0 million), 13.2% below last year, and underlying basic earnings per share was 25.6 pence (2007: 26.2 pence), 2.3% below last year.

Net debt at the year-end was £1,268.1 million (2007: £1,189.1 million).

The 2008 financial year saw the first full year of the smoking ban, a weakening economy and significant increases in input costs. Trading in the second half was also impacted by poor weather over the summer months. Overall however, the sales performance of our trading divisions was resilient as described in the divisional performance sections.

Our preparations for the smoking ban included investment of approximately £20 million in outside areas; the disposal of pubs with the greatest exposure to the ban and limited growth potential; and the continued development of our food offers. The impact of the ban has been consistent with our expectations. In general, food-led businesses have performed more strongly than wet-led pubs; well-located pubs with good outside areas have performed better than those with limited amenities; and food sales have increased as drinks sales and income from gaming machines have declined.

The reduced operating margin of 24.3% (2007: 25.0%) reflects higher input costs and the change in sales mix, with food sales generating slightly lower margins than drinks sales and income from gaming machines. Energy, utilities, brewing ingredients and food prices increased by approximately £6 million in 2008 and, as previously anticipated, are forecast to rise by up to £12 million in 2009, although we now expect inflationary pressures to reduce from the second half of 2009. We aim to offset most of these increases through tight cost management.

In the current trading environment, we have sought to minimise any increase to the retail price of beer and food and to the wholesale price of beer. Operating costs have been reduced by improved purchasing terms with a range of suppliers, and through cutting overheads by combining training, credit control, trade marketing, finance and administration services of Marston's Beer Company and Marston's Pub Company to improve efficiency.

The exceptional cost of reducing overheads was around £4 million and the resulting cost savings are expected to be over £4 million per year from 2009 onwards.



The industry

We operate around 2,250 pubs in a UK pub sector comprising around 63,000 pubs. Our products account for approximately 9% of the UK ale market with our share of the premium ale market in pubs around 20%. Our share of the premium bottled ale market is approximately 18%, increasing from around 8% last year following the acquisition of the Wychwood Brewery.

Changes in consumer habits, the smoking ban and investment in pubs and pub food have altered the nature of pub usage. More pub visits by women, families and an increasingly mature population led to our development of the 'F' Plan in our managed pubs — an increased focus on food, females, families and 'forty/fifty-somethings'. We estimate that 65% of all pub visits in Marston's Inns and Taverns are food related, with food sales representing 36% of all retail sales.



2



3

Intensifying competition, the smoking ban, aggressive price discounting by supermarkets and the weak economy have led to increased polarisation in the marketplace. Some 2,000 pubs are expected to have closed in 2008, with a similar number likely to close in 2009. In anticipation of this trend Marston's Pub Company has churned its pubs aggressively in recent years and as a result we have a high quality estate. At the same time, we have been careful to ensure that rents are set at sustainable levels.

In brewing, 'real ale' has been increasing in popularity as consumers have become more interested in beers with taste and provenance. Marston's Beer Company offers an outstanding range of own beers from five different breweries and saw premium ale volumes increase by 17.5% in 2008.

Beer consumption in pubs has been declining overall for many years, but there has been consistent growth in the volume of beer sold in the off-trade. Marston's Beer Company is the largest supplier of premium bottled ale in the UK market and the largest brewer of organic ale.

The pub sector has become dominated by a small number of large, specialist pub operators in recent years. The Group is one of a small number of vertically integrated pub operators and brewers, and we believe that this business model has clear advantages. We have greater economies of scale, as we distribute to over 4,000 pubs and clubs; we brew our own ales and control our own supply chain; and we can employ overheads more efficiently as demonstrated by the creation of the 'Centre of Excellence' for Marston's Beer Company and Marston's Pub Company.

Business and Enterprise Committee Inquiry

The Department for Business, Enterprise & Regulatory Reform is currently investigating the response of pub companies to the recommendations of the 2004 Trade and Industry Select Committee (TISC) inquiry into the nature of the relationship between pub operators and their tenants and lessees.

Pictured:

- 1 The Squirrel, Ludlow.
- 2 A selection from our portfolio.
- 3 Inn on the Furlong, Ringwood.

BUSINESS REVIEW



Following the TISC inquiry, Marston's Pub Company issued a clear Code of Practice which has been approved by the British Institute of Innkeeping and we believe that we have complied with the recommendations of the Committee.

Beer duty

As part of the April 2008 Budget, the Chancellor of the Exchequer increased duty on beer by around 9% and introduced a formula whereby duty will increase by at least 2% more than inflation over the next two years. In the recent Pre-Budget Report, beer duty was increased by a further 8%.

This additional tax burden is extremely onerous for small owner managed businesses including pub tenants. In our view it is contributing to the increasing disparity in prices between pubs and the off-trade and is threatening the positive contributions that many pubs make to communities throughout the country. We strongly support industry bodies, including the British Beer & Pub Association, in campaigning for a reduction in beer duty through the launch of the 'Axe The Beer Tax' campaign.

SUMMARY OF STRATEGIC OBJECTIVES

Our strategy has six key elements:

1. Target growth through the development of a national, high quality pub estate;
2. Develop greater food skills and extend our appeal to new customer groups;
3. Recruit skilled tenants and lessees better able to compete in a developing market;
4. Increase distribution of our ale brands;
5. Create greater value for shareholders through vertical integration; and
6. Match freehold assets with long term fixed rate financing.

In recognising that the general economic situation has changed significantly in recent months, our priorities for this coming year reflect a greater emphasis on managing the business in challenging conditions and on ensuring that when the trading environment does improve we are in a good position to benefit. Our priorities for 2009 are in 8 key areas as described below:

■ Optimising pricing and promotions.

Retail pricing throughout 2009 will reflect our continuing aim to offer outstanding value in all formats. Approximately 90% of our managed pubs offer promotions on food or drink, with around 35% of sales being promoted lines. Key trading periods such as Christmas will attract early booking discounts and other targeted promotions. We will also conduct range reviews to ensure that we are offering value by retailing good, price-competitive brands.

In brewing, we are focused on building value through higher margin brands and trade channels, such as premium cask ale and premium bottled ale.

■ A focus on innovation and current consumer trends.

Our managed pub design continues to reflect contemporary styling including the use of open kitchens in new developments, with an emphasis on 'fresh' and 'freshly prepared'. Recent examples include the opening of Bluu Bar Brasserie, Moorgate London; Pitcher & Piano, Chester; and the Stag's Leap, Rugeley.

The future development of our accommodation business will include partnerships with other lodge operators where appropriate. We have recently completed the refurbishment of rooms for accommodation in our managed pubs. Following the launch of online booking and the Marston's Inns website (www.marstonsinns.co.uk) we have seen steadily rising occupancy.

Recent additions to our portfolio of ales give us access to an unrivalled range of beers to offer to consumers and retailers. During 2009 we will exploit the strength of this portfolio in all areas of our business.

In 2008 we introduced a variable rent agreement suitable for high turnover food-led pubs. In 2009 we plan to offer more flexible new agreements including a variable rent agreement whereby rent is linked to sales volumes. We believe that this will prove attractive to tenants in smaller, wet-led pubs, and reduce risk for tenants. We have also conducted retail price-support trials in some wet-led tenanted pubs which contributed towards increasing trade where price reductions were accompanied by significant improvements in retail standards. These trials will be extended and incorporated in the development of new agreements.

■ **A rigorous approach to pub standards.**

Customer perceptions of the attractiveness and value of the 'pub experience' are strongly influenced by the level of attention paid to service, hygiene, and the standard of maintenance of the pub and external areas. Whilst not all of these factors are under our operational control in tenanted and leased pubs, we will emphasise their importance in tenant recruitment, training and communications.

■ **Improved management of our beer brand portfolio.**

We will extend the distribution of our range of ales such that all key brands will be available to all our managed pubs, tenants and lessees, and free trade customers. This will be to the benefit of the Banks's, Marston's and Mansfield brands as well as to those acquired more recently.

In the off-trade our bottled ale portfolio will be focused on Marston's Pedigree, Marston's Old Empire, Hobgoblin, Wychcraft, Brakspear Oxford Gold, Ringwood Old Thumper and Jennings Cumberland Ale.

■ **Tightly controlled costs and continued delivery of excellent customer service.**

Combining certain support functions will reduce overheads by £4 million per year and further improve operational efficiency. New labour scheduling and stock control systems will benefit our managed pubs.

The risk in energy and utility costs has increased significantly in recent years. We now have fixed electricity and gas contracts in our pubs until at least September 2010. We will also be able to manage energy usage more efficiently as all of our managed pubs will have automated electricity meters installed during 2009.

■ **Ensure customer/consumer knowledge is current and meaningful.**

We will continue to conduct regular quantitative and qualitative analysis to test customer/consumer opinion.

■ **Aim to reduce net debt.**

We will do this by reducing capital investment from £117 million in 2008 to below £60 million in 2009 whilst continuing to invest maintenance capital at historic levels. We will also target the selective disposal of smaller tenancies and leasehold sites and expect to sell 50–75 pubs and unlicensed properties during 2009.

■ **Maintain high ethical and environmental standards.**

The Company is an active supporter of a number of industry bodies and will continue to actively promote the responsible retailing of alcohol. The Company is a member of the 'FTSE4Good' Index and was recognised by the Carbon Trust for work on environmental standards.

Pictured:

- 1 *Bluu*, Birmingham.
- 2 A selection from our Ringwood portfolio.



2