



ADNAMS FD
STEPHEN PUGH TALKS TO
PETER WILLIAMS ABOUT
BREWING, THE PITFALLS
OF HEDGING, AND
GREEN ROOFS.

Probing the issues

PHOTOGRAPHER: ROGER HARRIS

Stephen Pugh has been Finance Director at Adnams for three and a half years. He joined the company as a result of lunch with a former colleague who told Pugh he had seen his next job advertised in *The Financial Times*. Although he wasn't looking to move, at 35 miles away the company was nearer Pugh's Ipswich home.

"I wasn't looking to move but I thought it was an interesting company which did interesting things," he says. "It has got the right kind of attitudes and values."

Out of 500 applicants, Adnams, in Pugh's words, "fished me out of the pond".

Pugh says the company is open about being a responsible business.

"We look after stakeholders' interests generally. We do pursue shareholder value but we are interested in the long-term future of the business. It has passed through many generations and we have to do the right thing with customers, suppliers, staff and the local community because if we don't we won't be there for the long term."

The pub sector has undergone dramatic changes over the past few years. An interesting spectrum has emerged among regional brewers, ranging from brewers with some pubs through to those which are essentially pub companies that brew some beer. According to Pugh, many would view Adnams as a pub company although the company sees itself as a brewer with some pubs – its 80 pubs represents a relatively small estate.

The pub-centric companies which have grown substantially over the last few years, such as Greene King and Marstons (the former Wolverhampton & Dudley), have undergone various financial

A taste of Adnams

A traditional brewer of classic English beer, Adnams has been in business for more than 130 years. With a turnover of £45m a year, based in the coastal resort of Southwold in Suffolk, the company owns around 80 pubs, mostly in East Anglia, as well as a couple of hotels in Southwold. A regional brewer, Adnams also has a long-established and thriving wine business, and recently opened a handful of cellar and kitchen stores.

With more than 300 employees, Adnams has an important presence in the local economy. Finance Director Stephen Pugh says: "We are well thought of in the local community and we work hard to ensure that view remains the case."

The company also lays claim to green credentials – in Pugh's words, "green before it was fashionable". In September 2006 Adnams opened a new distribution centre just outside Southwold, with a green roof covered with sedum – a living carpet of low-growing succulents (plants with thick, fleshy leaves and stems, which makes them suitable for growing in the inhospitable conditions found on a roof).

A new part of the brewery is to be opened shortly with a brewing system designed to be substantially more energy-efficient than the previous long-serving plant.

Quoted on Plus Markets, perhaps better known by its old name Ofex, Adnams is one of around 30 family brewers still in business in the UK. Shares have passed through family generations. The Plus quote reflects the desire to buy and sell the shares evolving from over-the-counter dealing in the shares to a more formal market. The company has split share capital; there is an unquoted block of A shares, while the Plus quote relates to the B shares. The company has balance sheet equity, unvalued, of £17m – the pubs are held at historic value – and debts of £16m.

restructurings, gearing up and securitising debt and heavily leveraging their pub estate. Inevitably, this has been partly driven by private equity-type interest with, for instance, property tycoon Robert Tchenguiz stalking Mitchells & Butlers. And within the industry itself there is hot discussion about whether or when some brewers will turn themselves into real estate investment trusts (REITs).

Although Adnams has geared up over the last few years, it does not see these moves in the industry as wholly positive.

"We suspect the increased leverage is leading to underinvestment in pub estates and shorter-term horizons than companies really ought to have," says Pugh. "Because we have got a stable shareholder base we feel we are positioned to take a long-term view of our actions – hence our environmental credentials and brewing system. We believe in backing the long-term future of the business."

"I don't believe most private equity-backed businesses would have been doing something

comparable because they would have been looking at an exit in three to five years. Similarly fully listed PLCs under quarterly or half-yearly analyst inspection would also tend to be driven by shorter-term issues than we are."

Adnams' gearing may be higher than its historic levels but it does not match the levels of FTSE companies. Adnams went for higher gearing because it saw investment opportunities (the distribution centre, the brewery, the retail outlets) and an element has been a switch from pension debt to actual debt. The company injected a £4.25m lump sum into the pension scheme about 18 months ago. At



the same time it closed the scheme to future accrual, having already closed the scheme to new members in 2002. The accrual closure means benefits for existing staff are frozen and no further entitlement for pension is accrued, except for inflation increases.

"That is a very tough decision, especially when many see companies like ours as paternalistic," says Pugh. "We saw it as part of our wish to be there in the long term. We saw the pension fund obligations as a major burden which was going to hamper the company unless we dealt with it. So we took some decisive action so that the deficit was reasonably closed. We are aware we are managing a large pot of assets and a large pot of liabilities but at least they are more closely aligned than they were a few years ago."

Pugh deliberately took the decision not to be a trustee of the pension scheme to avoid a conflict of interest but he does attend all pension scheme meetings as the company representative.

First and foremost, Pugh sees himself as an economist. Economics runs through the family: he has an economics degree, his wife is an economist, his father-in-law was an academic economist. A recent read has been Eric D Beinhocker's book *Origin of Wealth: Evolution, Complexity and the Radical Remaking of Economics*, which looks at how economic analysis should take place and how it can be used to understand how economies and businesses can grow.

An accountant by training with what was then Price Waterhouse, Pugh spent a couple of years with the Midland Bank (now HSBC), followed by five years with NM Rothschild. In his banking career he worked on international taxation and overseas structures, group financing, central finance and regulatory and compliance issues.

He then spent time in his only pure treasury role with Fisons in Ipswich, working as a treasury manager. After that he spent five years as FD of fashion brand Burberry where treasury was low on the to-do list as it was a subsidiary of Great Universal Stores at the time.

And before Adnams, he was Director of Corporate Finance at the Economist Group, working on a range of issues: treasury, tax, investment appraisals and share valuations.

As well as being a chartered accountant, Pugh passed the exams for the Chartered Institute of Taxation before adding the FCT initials.

Unusually, he paid for the ACT exams out of his own pocket when treasury was in its infancy. The subject interested him because of work and the accountancy syllabus scarcely mentioned treasury. The cost was £500 but it was money well spent as the prize he won for his liquidity management paper recouped his investment.

Attending the summer school course, Pugh suggested that the tax syllabus could be improved. He was subsequently asked to take it on

himself and for the next five years of summer school he lectured on the taxation of treasury instruments and international tax.

At Adnams, Pugh and his finance team look after treasury. "The big issue for most pub companies is interest rate management," he says. "For the highly geared it is all about long-term swaps, ensuring income is matched from the pub estate. Because we are a wider business than just a pub estate, we have not sought to do that. Our debt is mainly short term; we are confident we can roll that over when and with whom we wish to. We haven't geared to a level where that would be difficult for us."

Pugh is not afraid to express unorthodox views. Most notably, he says that in many cases "hedging is not a good idea".

"It comes with a cost and so has to be justified," he explains. "Mechanistic hedging is moving cashflows from one period to another. You are not actually changing the cashflows. If you are interested in maximising cashflow back to shareholders then why are you hedging? All you've done is move this year's rates to next year. You are still going to get them, just at a different point in time. Some may hedge opportunistically. To put it bluntly, some companies, although they may be reluctant to say it, think they can outguess the market and act accordingly. Adnams does not have the resource to have anyone analysing to that depth and feel confident to behave in that way.

"The better reason for hedging is practical. If I don't hedge, I am going to run into operational or covenant issues. If you are highly geared or have huge FX movements there may be grounds for hedging."

Pugh doesn't give financial covenants, but keeps policy under review as gearing becomes higher.

As recently appointed Chairman of the ACT's Policy and Technical Committee, Pugh also keeps ACT policies under review. A member of the committee for eight years, Pugh sees its goal as educating the membership about current treasury affairs and getting ahead of the game on likely legislative and regulatory developments so the ACT can think about, lobby on and influence the issues that matter to treasurers.

Pugh encourages treasurers to join the debate – and the committee. "We want enthusiasm and a broad range of treasury knowledge – none of us are the ultimate experts – and an interest in probing the issues. If you've got that, we'd be delighted to see you on the committee."

As far as Pugh is concerned, treasurers should be interested in the concepts of how markets work and offer a unique perspective on financial issues with insights that others may not possess.

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