



INDUSTRY UPDATE

QUARTER 4
YEAR 2019

Hospitality

Restaurants

The UK restaurant industry has proven resilient against a backdrop of continued economic uncertainty.

The industry's performance is closely linked to consumer confidence and household disposable income, both of which have been recovering in recent times. This has encouraged consumers to return to restaurant dining, and as a result sector revenue has grown at a CAGR of 3.5% over the last five years.



Overview

It is no secret that this is a challenging environment for the industry given the political and economic uncertainty driven by the UK's impending departure from the EU. It is expected that the negative impact of the current environment will be more than offset by changing trends that will positively affect the restaurant industry. Therefore, industry revenue is forecast to grow at a slow but steady compound annual rate of 1.3% over the next five years.

Restaurants that lack agility and offer outdated concepts are most at risk in this environment, as shown by the well-documented struggles of Jamie's Italian and Prezzo. Nevertheless, brands that have adapted to accommodate changing consumer tastes, such as Loungers and Wagamama, are thriving. This has encouraged investment activity and plenty of opportunities remain for brands to add value through innovation.

Industry Trends

The industry's development in recent times has been shaped by changing consumer tastes, with this trend expected to persist going forward. Consumers are moving away from traditional cuisines that have historically dominated the high-street, with new flavours such as Thai and Mexican shifting into the mainstream.

UK's changing consumer tastes from 2013-2018

123%

The number of Thai restaurants more than doubled, increasing by c. 123%

49%

The number of Mexican restaurants increased dramatically, rising by c. 49%

-4%

Growth in the number of Italian restaurants slowed significantly, and in fact fell by c. 4% in the last year

The global paradigm shift towards a preference for healthy consumption has supported the growth of brands that align with this concept, with particular regard to vegetarian / vegan offerings. A recent survey found that there were more vegetarian restaurants opened in 2018 than burger-led and steak-led restaurants combined. This trend is driven by increasing awareness of the long-term benefits of healthy eating combined with a steady shift towards a preference for more environmentally responsible consumption. Many innovative concepts that have embraced sustainable healthy dining have experienced strong growth in recent years.

Generational trends are also prevalent in the industry. Millennials continue to show a preference for experiences over material goods, with 78% of millennials opting to spend money on an experience rather than purchasing physical goods. This has led to a rise in the popularity of "experiential dining". Further compounding this is the fact that each new generation

tends to spend a greater portion of their income on food and drink than their predecessors. As they approach their peak earning years, millennial and Gen Z preferences will only have a greater impact on the growth and development of the industry.

M&A Activity

With the current industry trends on course to continue, investors remain hungry to acquire innovative and agile brands to ensure they are well positioned to capitalise when the economy eventually rebounds.

There is strong investment activity within the sector, with a greater focus on ensuring that brand concept and image align with the current market demographic. The sector is highly competitive with low barriers to entry. Outdated concepts and models are unlikely to deliver growth, while modern on-point brands have the potential to scale rapidly. As a result, investors are looking to acquire growing, proven, and replicable concepts.

Some investors have been deterred by the uncertainty associated with the current economic and political climate. Despite this, specialist operators in the space continue to invest in concepts that capitalise on the trends discussed. This activity is fuelled by the cheap debt available in the current low interest rate environment. Additionally, the deflated pound has presented an opportunity for overseas investors to acquire UK assets at a relative discount.

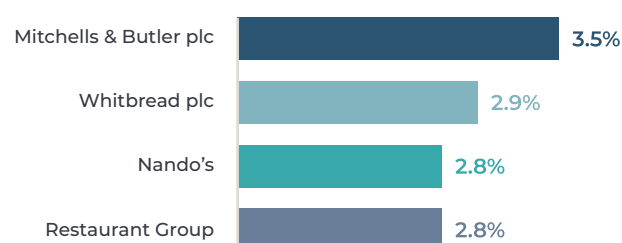
Across the first half of 2019, appetite for investment activity has been relatively strong within the wider food and beverage sector, although there has been a notable lack of “mega-deals”. There were over 100 deals completed during this period, with some notable recent transactions presented below.

Company Name	Deal Size (M)	Deal Type	Investor	Date
Vinoteca	Undisclosed	Venture Funding	Baronsmead and Gresham House	September 12, 2019
Harry Ramsden's	Undisclosed	Acquisition	Deep Blue Restaurants	August 26, 2019
Mildreds	Undisclosed	Acquisition	Encore Capital	August 1, 2019
Reds True Barbecue	Undisclosed	Acquisition	Tokyo Industries (UK)	June 27, 2019
Tonkotsu	5.00	Development Capital	YFM Equity Partners	June 11, 2019
Wasabi (UK)	Undisclosed	Development Capital	Capdesia Group	May 10, 2019
Loungers	83.25	Initial Public Offering	Initial Public Offering	April 29, 2019
Farmer J	1.90	Development Capital	Imbiba	February 1, 2019
Thunderbird Fried Chicken	Undisclosed	Development Capital	TriSpan	January 24, 2019
Wagamama	357.00	Acquisition	The Restaurant Group Plc	December 24, 2018

A mixture of trade acquirers and financial institutions are the investors in the majority of these recent deals.

Market Structure

Due to the low barriers to entry within the restaurant industry, there are a large number of small operators, which means market share remains fragmented. Hence, there are no companies in the industry with a market share of more than 5%. Some of the largest players include Mitchells & Butler plc with a 3.5% market share, followed by Whitbread plc at 2.9%, whilst Nando's and the Restaurant Group both have 2.8%.



Threats to the Sector

Social trends normalising busier lifestyles have boosted demand for convenience food, as time-poor consumers aim to make better use of their spare time. This has led to restaurants facing greater competition from fast food concepts, cafés, and pubs, as many consumers now favour quick catering options to suit their fast-paced lifestyles. In recent years, this trend has snowballed due to the rapid evolution of online food delivery services, such as Deliveroo and Uber Eats. This poses a threat to restaurant dining as consumers now have the option of having restaurant quality food delivered to their doorsteps. Restaurants such as Nando's have adapted



to this preference by forgoing table service to decrease wait times for those consumers who are pressed for time.

From 2015 to 2018, the number of chain restaurants in the UK rapidly expanded from 984 to 5,005, driven by, amongst other factors, the cheap debt available to investors and the low barriers to entry. This has led to a highly saturated market that is placing downward pressure on margins, with the issue further compounded by the dual cost impacts of rising business rates and minimum wage increases. A number of restaurant chains have been affected by this, with some notable groups listed below.

Company Name	Date	Development
Thai Leisure Group	October 2019	Approved plans to enter into a CVA
Pizza Express	October 2019	Reportedly in talks to restructure debt
Boparen Restaurant Group	March 2019	Announced plans to close 27 Giraffe and Ed's Easy Diner restaurants
Jamie's Italian	February 2018, July 2019	Closed 12 sites, Entered into administration
Gourmet Burger Kitchen	November 2018	Announced plans to close 17 sites
Gaucha Group	July 2018	Entered into administration
Carluccio's	May 2018	Entered into a CVA and closed 29 sites
Prezzo	March 2018	Announced they will shut 92 loss-making restaurants
Byron Burger	January 2018	Entered into a CVA and closed 10 sites

Despite a number of closures, landlords are unlikely to rent their empty properties to businesses outside of the sector, particularly when they have a fully fitted kitchen and other facilities. However, this will only continue until the amenities are no longer usable for restaurants. Then, landlords will be forced to fill their properties with non-restaurant businesses, which would lead to a shift in the marketplace and start to reduce market saturation.

Outlook

The UK restaurant industry is in the mature stage of its life cycle, as indicated by the degree of market saturation. As such, industry revenue is forecast to grow at a low but consistent annual rate of 1.3%.

Traditional revenue growth is being constrained in the short term by economic and political uncertainty. Some restaurants are also struggling to boost revenues in the face of falling high-street footfall and competition from tech enabled food delivery services. Cost pressures are expected to have a direct impact on bottom line in the short term, with the competitive nature of the industry often dictating that operators are not able to pass these costs on to customers.

Changing consumer tastes and industry trends represent a threat to established chains but are an opportunity for new entrants and those concepts that are willing and able to adapt. This is leading to strong M&A activity in the sector as both financial and trade buyers look to capitalise.





In the longer term, the expectation is that the economy will eventually recover, supporting growth within the industry. This growth will be further supported by an increase in awareness and acceptance of existing trends, such as healthy sustainable living. Firms that have invested during the current period and committed to the catering for modern demands will be well positioned to benefit in the long run.

The industry is performing relatively well with consistent growth against a backdrop of uncertainty and continuing pressures on cost. There are exciting opportunities for investors that are able to recognise and capitalise on innovative, modern brands.

Gerald Edelman services

We have significant experience in and deliver a range of services to those in the restaurant industry, including:

- ▶ Business development and strategy
- ▶ M&A and deal advisory
- ▶ HR advisory
- ▶ Tax planning and advice
- ▶ Valuations
- ▶ Due diligence
- ▶ Funding solutions



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