RESTAURANTS AND BARS REPORT 2023

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THE RESTAURANTS AND BARS REPORT 2022

No sooner had we welcomed the regression of COVID-19 related stories and operational challenges than we saw inflation sky rocket, UK Government instability and near constant headlines about long term recession.

As we know, however, our sector is nothing if not resilient and the skillsets of so many operators have now been enhanced such that supply chain issues, labour shortages, rail strikes, and energy contracts are merely another part of the day job.

In this year's report we want to reflect on what we are seeing as the key challenges and responses of consumers and operators, its impact on deal flow and opportunity for success alongside our usual assessment of some of the key regulatory challenges hitting the sector. We also wish to continue our focus on the sustainability agenda which we know is so central to our sector's thinking now but can sometimes be challenging to work through exactly where it should land on the priority list.

A WORD FROM MARK EDWARDS

PARTNER AND HEAD OF RESTAURANTS AND BARS

Welcome to the 2023 edition of our annual Restaurant and Bars report: a focused insight into consumer behaviour and trends in the sector.

For each of the last three years I have noted that we cannot remember a time when trade has been quite so impacted by factors beyond operators' control and in so many ways 2022 was no different. Forecasting in today's environment is described as something of a mug's game with crystal balls in very short supply. What we can be sure of though, is that with the right support from financing partners and, one hopes, a stable, business focused UK Government, we are likely to see innovation, fresh concepts and a relentless focus on operational excellence.

The Boardroom agenda for so many will be split between the immediate trading priorities including driving revenue to protect cost increases, the medium term financing options as debt financing costs are likely to be substantially higher than they have been for a decade, and the longer term sustainability questions that Government policy and consumers are going to demand.

We are delighted to be able to support you as you navigate the challenges and opportunities of 2023 and beyond. I hope you find our report interesting and informative, and we would be delighted to discuss any of the issues highlighted with you so please do get in touch.

I wish you all every success for 2023 and beyond.

MARK EDWARDS
Partner
Head of Restaurants and Bars

MARKET OVERVIEW

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Following the challenges of the pandemic, hospitality firms were hoping for a year of recovery. However, with record inflation, supply chain disruption, and a labour crisis to contend with, 2022 has been far from easy. BDO's Strategy & Commercial Due Diligence team examines these macro-challenges in more detail, and looks at how both consumer and hospitality businesses are responding.

INFLATION

Rising costs from the Russia's war in Ukraine, the aftermath of the pandemic, and political uncertainty have led to soaring inflation. The UK rate reached a near 40-year record, with CPI peaking at 11.1% in November. This has impacted consumers and businesses alike.

Consumers faced a winter energy price cap 96% greater than the previous year, while mortgage rates reached highs of 6.5% in October. Rent rose by 20% in some areas. Correspondingly, average discretionary spending dropped by 11.4% year-on-year in November, while the bottom 40% of households now have negative discretionary income (*Asda Income Tracker*).

Annual food inflation jumped to 13.3% in February 2023, up from 12.4% in November, according to the latest monthly report from trade body the British Retail Consortium (BRC) and the data firm Nielsen. The BRC said this was the highest monthly rate since it began collecting data in 2005.

For restaurants and bars, reduced consumer spending, rocketing utility bills, food inflation, and a planned rise in business rates for April means a fight for survival. 35% of UK hospitality firms worry they could be operating at a loss or cease trading completely by the end of 2023 (*survey by UKHospitality, BBPA, BII and Hospitality Ulster*).

How are consumers responding?

Over half of Brits plan to cut back on their discretionary spending in order to put the money towards energy bills. Of these people, 6 in 10 intend to achieve this by reducing how often they eat out (*Barclaycard*); 77% of UK hospitality firms reported a decrease in diners and drinkers at the end of last year (*UKHospitality, BBPA, BII and Hospitality Ulster*).

Our consumer sentiment survey (Q4 2022), available on the BDO website, shows that drinking and eating out were two of the worst performing categories looking back over the last 6 months at -34 and -30 respectively. However, net spend intention looking forward is slightly more positive for drinking out.

With more evenings spent at home, the food delivery market should benefit. Having already taken a share of the eating-out market during COVID-19, the UK takeaway market is forecast to grow from £10.5bn in 2021 to £14.6bn in 2025. Consumers perceive takeaways as better value for money and more convenient, while many people are continuing to order-in more than pre-pandemic as a result of habits laid down during lockdowns. This desire extends to grab-and-go and collection services: in March 22, 52% of UK consumers stated they would purchase online and collect themselves rather than receive delivery if the option was available (*Statista*).

For consumers who continue to eat out, finding value for money will be crucial. This means a holistic quality offering, including food, service and atmosphere, but also a good deal: a June survey found 72% of restaurant customers to be price-led (*Lumina*). When dining out, 89% of consumers intend to find resourceful ways to save money next year, including seeking discount vouchers (47%), cutting their bill by skipping a course (45%) or choosing a cheaper meal (44%) (*IGD*). Older customers are more likely to pay cost rises for their dish and see quality maintained, while younger customers pay less but are prepared to receive lower-quality ingredients (*Mintel*).

The Market at a Glance

CHALLENGE	CONSUMER RESPONSE	HOSPITALITY SECTOR RESPONSE
Rising costs and inflations.	Cutting back on dining out, switching to delivery, and looking for value for money.	Reducing energy usage, developing delivery channels, and utilising pricing strategies to capture customers.
Supply disruption and shortages.	Greater awareness around food miles, provenance, and sustainably sourced produce.	Sourcing locally, developing dishes focused on cheaper ingredients, and adjusting supplier numbers to reduce risk and improve margins and control.
Labour shortages and loss of experienced staff.	Looking for the best quality service available, which for some means switching to more welcoming independent businesses.	Assessing where technology and digital tools can help reduce operating costs.

HOW IS THE HOSPITALITY SECTOR RESPONDING?

More than any other industry, hospitality businesses are reducing opening hours to combat rising energy costs. An ONS survey revealed that 21% of food and drink businesses are reducing hours, while 6% are cutting trading by two or more days a week.

Restaurants and bars are also using pricing strategies to capture and retain customers, and to encourage higher spending. Big brands such as KFC and Burger King are using digital apps to push promotions and increase demand. Price bundling is being used to enhance consumer value perception, with consumers likely to purchase more dishes than they would have otherwise. For example, Honest Burger have released their 'most affordable ever' burger and chips at £8.50, or The Ivy's set menu of three courses for £27.50.

Similarly, tiered pricing is enabling restaurants to improve upselling and capture a wider customer base. Maintaining cheaper items encourages younger or cost-conscious customers, while more premium options help to justify price increases. In November, premium side dishes were shown to be on the rise, with newly introduced options 23% more expensive on average (Lumina).

Businesses are also looking to satisfy the consumer switch to delivery. The growth of the global dark kitchen market is proof of this; it is forecast to double in size from 2021 to 2027 (Statista). These purpose-built delivery sites are less capital intensive than opening a restaurant and offer quick brand growth. Deliveroo and Food Stars are among the UK's biggest dark kitchen providers, offering large rentable kitchens which can accommodate multiple brands at once.

Percentage of businesses (curently or paused trading) saying they had taken or planned to take actions to reduce energy costs by action and industry in the UK. 17 to 30 October 2022.

Cut trading hours while trading days stay the same

	ACTION TAKEN IN THE LAST 3 MONTHS	ACTION PLANNED FOR NOVEMBER
Food and drink services	21%	21%
All businesses	3%	3%

Cut trading by one day a week

	ACTION TAKEN IN THE LAST 3 MONTHS	ACTION PLANNED FOR NOVEMBER
Food and drink services	7%	7%
All businesses	2%	2%

Cut trading by two or more days a week

	ACTION TAKEN IN THE LAST 3 MONTHS	ACTION PLANNED FOR NOVEMBER
Food and drink services	6%	6%
All businesses	2%	2%

Source: Office for National Statistics (ONS) - Business Insights and Conditions Survey

MARKET OVERVIEW CONTINUED

SUPPLY CHAIN

Further to inflation, the war in Ukraine and ongoing lockdowns in China have brought about supply chain disruption and scarcities of food and equipment. In the UK, McDonalds were among the restaurants who issued statements about missing menu items due to unavailable ingredients.

Short supplies have also led to rocketing food prices. The CGA Prestige Foodservice Price Index showed record inflation of food at 21.5% in November, a tenth consecutive month of double-digit inflation. A survey by Fourth showed that the worst hit commodities for UK restaurants are dairy (up by 40%), and grains and meat (up by 35%).

How are consumers responding?

With greater awareness of sustainability post-pandemic and the higher cost of transport, consumers now have heightened concern around the provenance of their food. 81% of UK consumers believe that sustainability is important when dining out, while 73% think the food service industry could do more to promote sustainable dining. 63% would be willing to pay more for more sustainable options when dining out (*Nestle Professional*).

Many place importance on sourcing ingredients closer to home, both to minimise food miles and support local businesses. 66% of consumers agree that Italian restaurants should use more locally grown ingredients, while 54% of pub diners are willing to pay more for locally sourced food (*Mintel*).

HOW IS THE HOSPITALITY SECTOR RESPONDING?

Sourcing food locally can offer hospitality businesses greater sustainability and lower transport costs, while mitigating congestion in global supply chains. Food outlets that publicise their attempts to minimise food miles are coming to the fore. For example, Pizza Pilgrims' sustainability concept outlet in Selfridges purchases all their basil from a hydroponic system at Harvest London, saving 250,000 air miles a year. Similarly, the Gladwin brothers' restaurants, which offer 'local and wild' products, are experiencing momentum and opening their 6th neighbourhood restaurant concept this year.

Additionally, businesses are also adapting to focus on cheaper ingredients, streamlining menus to offer fewer dishes and reduce waste, or cutting back on supplier numbers to lower supply chain risk. In 2022, 31% of restaurants reduced their menu offering to counteract rising costs - Blackheath restaurant Copper & Ink, reduced its menu to just nine dishes - while 38% adjusted their number of suppliers to help supply chain management (Restaurant Dive). Plant-based alternatives are growing, and allow restaurants to move away from pricier dairy and meats, while catering to the growing number of UK vegans.

LABOUR

On top of inflation and supply chain issues, hospitality businesses are facing a devastating labour crisis, brought on by intensified visa regulations post-Brexit and the movement of workers to other industries during COVID-19. In November , 1 in 9 hospitality jobs were vacant (CGA), despite ongoing major recruitment campaigns. A third of UK hospitality businesses were forced to reduce opening hours over Christmas as a result of staff shortages (Future Shock).

Labour shortages have led to further pressure on profit margins, and not only from diminished opening hours. The sector has lost more experienced staff in particular; this leads to less efficient service, which is more costly. In order to attract talent, restaurants have had to raise wages; average pay has risen in the sector by 9% in 2022 according to CGA.

To add to this, with the heightened use of contractual labour through agencies or umbrella companies, businesses are experiencing more complex and costly administration over employment tax implications; for example, HMRC's requirement for PAYE due diligence of labour supply chains.

IF YOU WISH TO DISCUSS YOUR BUSINESS WITH US, PLEASE GET IN TOUCH AT: TOM.HOLT@BDO.CO.UK.

How are consumers responding?

In an inflationary environment, consumers are placing greater emphasis on experience when dining out – of which good service is part and parcel. While meeting and greeting is deemed the most important factor in good service, ongoing staff engagement and efficient provision of the bill and payment processing are also high contributors (HospitalityGEM).

With a lack of trained staff potentially impacting service, consumers may switch to independent businesses, which are regarded as more welcoming and atmospheric than homogenous chains. A survey by Pentallect found that independent restaurants were rated more highly than chain restaurants for good service, personalised service, community orientation, and being 'special'. Furthermore, 60% of UK diners feel that the welcome given by staff in independent restaurants was the most effective, compared to 13% at chain restaurants.

About the Consumer Strategy & Commercial Due Diligence Team

Our experienced Strategy & Commercial Due Diligence team has worked with major players across the hospitality sector. We understand the UK consumer and their dining and leisure habits, and how these will impact your business. Our hospitality-focused services include:

- Site location rollout, in the UK and internationally
- Asset model strategy
- Proposition and sales channel recommendations
- Competitor benchmarking and key learnings
- Supply chain and operations streamlining
- Revenue and cost analysis
- Improving customer experience
- Using consumer insights to develop and enhance marketing and branding.

Our team also has strong experience and knowledge of the retail and travel sectors.

HOW IS THE HOSPITALITY SECTOR RESPONDING?

Businesses are looking for ways to reduce their labour cost but maintain customer experience. Many are turning to technology for this. Digital shifts can replace the need for some staff members, and offer consumers more efficient services such as ordering and payment processing. The Big Mamma group launched their own time-saving payment app in 2021 called Sunday, which was quoted as saving one restauranteur 17% staff time after two weeks; the app raised Europe's largest ever seed-round ever. Wendy's have outsourced basic food preparation to suppliers, meaning less time and work for restaurant staff. Premade foods and bar mixers are gaining in popularity too.

Technology can also add to customer enjoyment and boost revenue: evidence shows that mobile ordering can increase average order value by 40% with the use of meal deals and cross-selling (Attractions), while one in five 18-24 year olds browse the menu for longer when it is digital, usually converting to higher spending (Lumina). Furthermore, the data collated by these digital ordering and payment apps can be used to understand customer demand and optimise staffing rotas. YO! Sushi sends dishes directly to guests on a conveyer belt after they order and pay digitally, reducing labour and building up a database of 250,000 people who receive monthly news.

Restaurants are using streamlined menus to deal with staff shortages as well as rising costs. 35% of UK hospitality firms plan to simplify menus this year to create more manageable workloads for staff.

M&A MARKET OVERVIEW

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Though the year started with an air of excitement and optimism, M&A activity remained subdued compared to pre-COVID-19 levels. A trifecta of headwinds – inflation, energy and war – softened consumer confidence and spending, adding further strain to P&Ls and M&A activity.

2022 started with all the hope of being a fresh, post-COVID-19, slate. The sector returned to unencumbered trading and buyers looked to reactivate growth strategies. Trade buyers quickly emerged as the dominant buyer pool – making strategic acquisitions to capture market share, unlock new growth channels and optimise portfolio mix / unit economics.

As war broke out in late February, inflation and energy costs rose. Consumer confidence softened. P&Ls came under pressure. The removal of VAT relief in April 2022 dealt a further blow to free cash flows.

For those M&A processes that were live and in-market, vendors faced increased levels of scrutiny over the underlying profitability of their estates over the short and medium term. Where transactions had not yet launched, vendors quietly opted to hold fire and wait for markets to settle.

The Pub sector saw the greatest level of M&A success throughout 2022 accounting for 40% of the year's 28 transactions; the year closed with an uptick in distressed transactions across the wider R&B and Coffee sectors. Ping Pong, Notes and AMT Coffee all entered Administration in November.

The Pub Sector showed the greatest confidence with a number of operators making bold moves to deliver equity growth for shareholders. Consequently, the Pub sector represented >40% of non-distressed UK Hospitality M&A activity in 2022.

2021 closed with a bang as Softbank-backed Fortress Investment Group announced its takeover of 1,300-site Punch Pubs for £1bn. This was quickly followed by SA Brain's sale of 100 freehold pubs, in January, to Song Capital and Cerberus for c.£100m (*Propel*).

In February, 32-site Brasserie Bar Co, which operates The White Brasserie and Brasserie Blanc brands, was acquired by Alchemy Partners for c.£40m as a standalone investment. The acquisition saw Soho Square Capital make a full exit (**Morning Advertiser**).

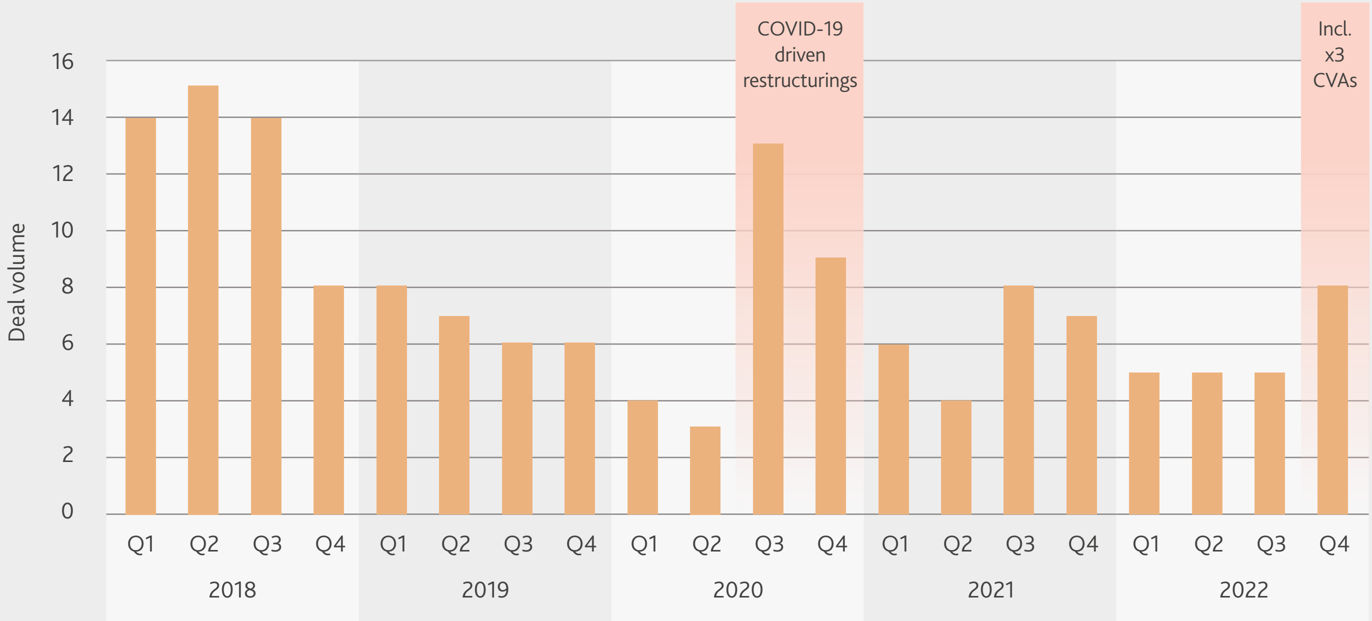
Days later, Alchemy completed a second deal within the Pub sector – this time exiting its investment in 31-site The Inn Collection, which had been quietly acquiring freehold inns and hotels across the Lake District during the pandemic, to the Harris family and Kings Park Capital. The sale valued The Inn Collection for >£300m (*Propel*).

March saw Portobello Starboard Pubs & Brewery, backed by Zetland Capital, acquire five pubs from City Pub Group (four freehold, one leasehold) for £16.2m, which together reportedly generated £0.7m EBITDA (**The Caterer**).

In May, C&C sold its remaining 47% stake in Admiral Taverns to Proprium Capital Partners for £55m. The disposal is understood to represent a 10.9x FY23 Company EBITDA multiple (**Propel**).

M&A MARKET OVERVIEW
CONTINUED

Figure 1: UK M&A activity across the R&B, Pub and QSR sectors (2019-2022).



Source: MergerMarket, Propel, BDO Intel

Since its acquisition in August 2021 by Rooney Anand's RedCat Pub Company, Kevin Charity's Coaching Inn Group (then owning 18 freehold inns) has been on an acquisition spree. The group has acquired five sites in 2021, and nine in 2022 including the Pheasant Hotel and Blakeney Manor Hotel, both in Norfolk, the Forest Park Country Hotel, New Forest and The Jamaica Inn, Cornwall.

In September, Downing backed 49-site managed pub company The Pub People Group of Companies. The company announced they will pursue an M&A led growth strategy going forward (**Downing**).

October saw **Greene King acquire Chester based Hickory's Smokehouse** – which operated 17 American style, family friendly smokehouses. Hickory's, which had an unblemished record of converting underinvested pubs back into the heart of their local communities, offers a strategic opportunity for Greene King to convert sites and grow Hickory's into a national brand.

A week later, the Hamish Stoddart and Lee Cash led, 21-site leasehold operator, Peach Pubs announced their sale to Revolution Bars (LON:RBG) for £16.5m. The deal represented a CY Site EBITDA multiple of 3.3x and CY Company EBITDA multiple of 5.5x inclusive of £1.5m of potential synergies (**London Stock Exchange**).

In September, Brewhouse & Kitchen, the UK's largest collection of freehold brewpubs that together brew more than 230 unique craft beers across the estate, announced it had appointed BDO to assess its strategic options in 2023.

Though the winter World Cup marked an early start and much needed boost to the Christmas trading period, train strikes throughout December will undoubtably soften trading. Looking ahead to 2023, we expect small and single-site operators, who have exhausted cash reserves whilst battling energy and cost inflation, may look to exit.

This will invariably provide opportunities for larger, well-capitalised operators to acquire prized sites that rarely come to market.

M&A MARKET OVERVIEW
CONTINUED

Current year performance and financial outlook has shown a great degree of polarity across the R&B sector, in cases creating a disconnect between vendor price expectations and buyer appetite. Consequently, the sector was under-represented with regards to 2022 deal activity – accounting for just 30% of non-distressed UK Hospitality transactions in figure 1.

Despite The Restaurant Group (LON:RTN) repaying £44m of its then £361m of debt in June and its commitment to converting sites into a Wagamama, broker consensus shows nervousness around its ability to offset inflation with price rises, control its exposure to rising interest rates and its brands' ability to maintain market share in the face of fiercer competition.

TRG themselves expect food and drink inflation to reach +10% in FY23 (c.+9% in FY22) and labour +6% (+6% FY22). Utilities, though now fully hedged, will likely increase by £12m in FY23 in addition to a £9m increase in FY22. TRG expect energy to finally decrease by c.£7m in FY24.

Fulham Shore (LON:FUL), owner of both Franca Manca and The Real Greek, had a more positive 2022 – though it's final quarter saw significant impact from cost-of-living pressures and train strikes. Positioned as a challenger brand to Pizza Express, Prezzo and Zizzi, FUL has opened six new sites in the y/e Aug-22 and launched its own retail range across 500 Tescos supermarkets in November. FUL which opened 18 new restaurants in FY22, experts to slow its growth to five to ten openings in 2023.

Both companies' share prices compared to their pre-COVID-19 levels paint an interesting picture: Figure 1 and Figure 2 (below).

At the time of writing, The Restaurant Group is trading at a 5.6x CY EBITDA multiple (adjusted to normalise impact of IFRS 16), whilst Fulham Shore is at 7.1x.

There was similar polarity amongst wet-led operators.

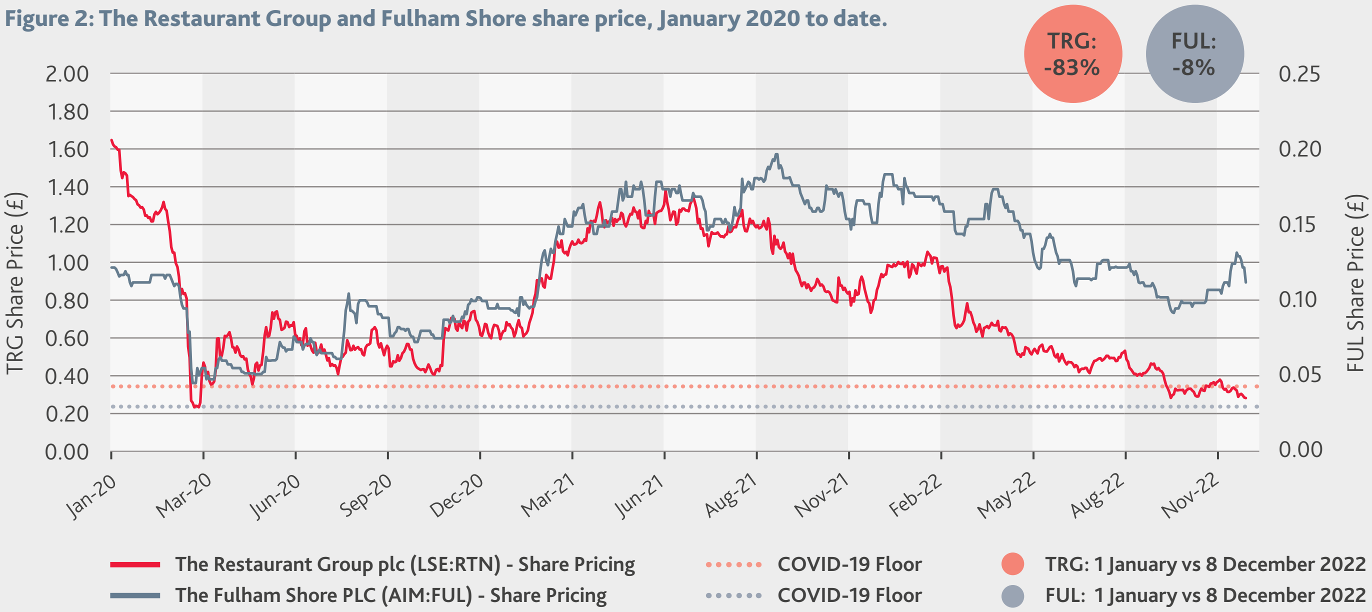
All-day, neighbourhood focused operator Loungers continued to see strong performance across its estate, with latest reported 4-month LfLs +17% compared to the equivalent pre-COVID-19 period. The company also announced it was on track to open 30 sites in the y/e Apr-23 whilst its comparably modest net-debt position of £9.5m limited its exposure to rising interest rates.

Despite the positives, no operator was safe from inflation and utility pressures. Loungers reported adjusted EBITDA margin erosion of 1.3% in H1-FY23 and revised their outlook on inflationary pressures facing the business in FY23 to +10% on food, +7% on drink, +9% on labour and +10% run-rate inflation on utilities. Loungers will need to implement a 7% price rise to offset pressures.

In 2022, Revolution resumed its expansion – on pause since 2018 - with two new openings in Preston (June) and Exeter (July). The two sites cost **£1.5m** and **£2.0m** respectively, which Revolution expects to deliver a modest four-year payback (LancsLive and DevonLive).

This was a notable change of tack, having spent 2021 focused on launching two

Figure 2: The Restaurant Group and Fulham Shore share price, January 2020 to date.



Source: CapitalIQ as at 8 December 2022.

M&A MARKET OVERVIEW
CONTINUED

new brands in a move to diversify away from its core city centre and late-night proposition: Founders & Co, a food hall, retail concept and Playhouse, a multi-activity competitive socialising venue.

Revolution was hit hard by the extended COVID-19 restrictions against the late-night sector and by Omicron which resulted in 1-year LfLs of +1.4% (for the period from re-opening in July 2021).

Revolution's share price stands in stark contrast to Loungers – highlighting investor nervousness as to how the late-night sector will trade in light of falling consumer confidence. Revolution is also facing a sharp increase in utility costs when it comes out of its fixed contracts in April 2023.

At the time of writing, Revolutions is trading at a 5.7x CY EBITDA multiple (adjusted to normalise impact of IFRS 16), whilst Loungers is at 7.2x.

In April, Leeds-based Arc Inspirations which operates Banyan, Box and Manahatta cocktail bars, secured a £19.0m investment from BGF. The transaction valued Arc at an Enterprise Value of c. £60m, representing an 8.0x multiple of Arc's FY22 (y/e March) Company' EBITDA of £7.5m (**Insider Media**).

The year also saw the "Battle of the Burrito" heat up, with key segment operators looking to capture market share.

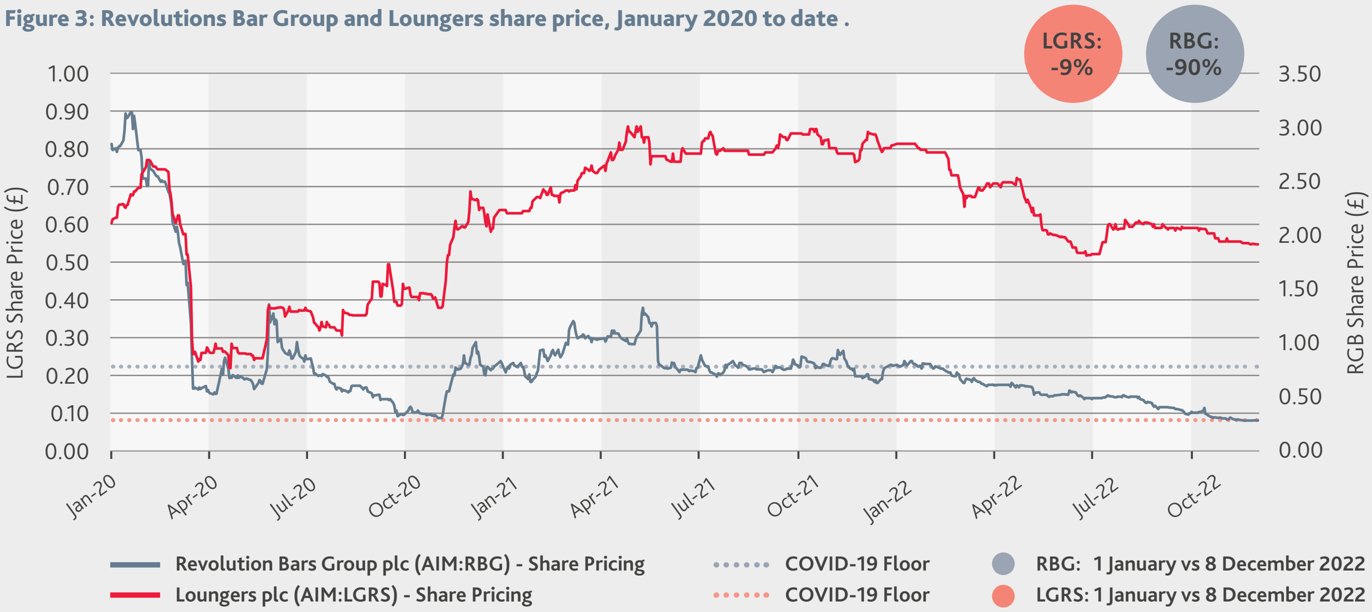
- In February, Belfast-based 14-site Boojum set out to secure growth capital to fund its expansion across Ireland and into the UK
- May saw Chilango, which had been bought out of CVA by RD Capital Partners in August 2020 for £1.0m, was acquired by Tortilla for £2.75m, representing a CY Company EBITDA multiple of 2.75x (**Tortilla Group**)
- In July, The Restaurant Group acquired Barburrito for £7.0m; a 4.4x CY Company EBITDA multiple for the 16-site chain. BGF had previously backed Barburrito between 2012 and its 2020 CVA, investing £3.25m (**Propel**).

In August, the founders of Hauser & Wirth gallery, Manuela and Iwan Wirth, acquired **The Groucho Club** for £40m, via their hospitality and development company ArtFarm. The company generated £2.4m EBITDA pre-Covid (y/e December 2019) and £1.5m in y/e December 2021 (**BigHospitality**).

September saw Epiris-backed The Big Table, previously The Casual Dining Group, acquire nine-site pan-Asian Banana Tree – providing a complementary brand in a growth segment, that unlocks conversion opportunities and optimises the wider estate (**Propel**).

In November, six-site Ping Pong dimsum restaurant chain entered Administration due to mounting liabilities owed to landlords. The company was sold via a pre-pack to AJT Dimsum, a new entity established by Ping Pong's existing management team (**Insolvency Insider**).

Figure 3: Revolutions Bar Group and Loungers share price, January 2020 to date .



Source: CapitalIQ as at 8 December 2022.

M&A MARKET OVERVIEW CONTINUED

Deal activity across the UK's coffee sector heated up further in 2022. Brands looked to accelerate growth and capture market share from peers. For Franchisors, that meant attracting new best-in-class operators to their system with the lure of attractive white space opportunities and compelling returns. For existing operators, inter-system consolidation was key.

The year kicked off with three transactions in quick succession:

- In January, Caffè Nero acquired SA Brain's remaining 33% stake in 102-site Coffee#1, having previously acquired 67% of the company in 2019. The acquisition follows Nero's £330m refinancing which ended EuroGarages' takeover bid
- In February, Scoffs, which operated 104 Costa Coffee, announced it was acquiring 20 equity owned stores direct from Costas (World Coffee Portal)
- SimTrava quickly revealed its own acquisition of 17 sites including four drive thrus, three retail parks and ten high street outlets for £7.1m (Business Live).

Starbucks also saw a flurry of activity throughout the year - in July, news broke that Starbucks Corp had appointed advisors to look at potential options for its UK business – crystallising expectations that Starbucks will eventually bring the UK into line with its international geo-license strategy. Starbucks UK operates c.1,100 stores, of which c.70% are operated by franchisees (The FT).

In September, Starbucks, KFC and Taco Bell franchisee Soul Foods Group, which operates c.400 sites across the UK and Canada, secured a minority investment from Centerbridge Partners, Metric Capital Partners, and OpCapita (MCA).

Connection Capital-backed Starbucks franchisee 23.5 Degrees, which had been expected to launch its own process in H1-2022, instead chose to focus on accelerating its own drive-thru focused roll-out across the UK.

In November, macro-economic pressures were beginning to show with smaller operators coming under financial pressure. Westbury Street Holding ("WSH Group") acquired 10-site coffee shop and wine bar concept Notes for an undisclosed sum. A week later, AMT Coffee, which predominantly operate coffee shops in transport hubs and hospital locations, entered Administration in November with 25 sites sold via a pre-pack to SSP Group for £1.75m (Insolvency Insider).

M&A activity across food-led QSR systems was less prominent than we'd initially anticipated a year ago; though we expect this will result in activity rolling into 2023 instead. Several transactions that did complete standout in particular...

Bridgepoint-backed Burger King UK ("BKUK") successfully completed its long pursuit of 74-site Karali Group - the UK's largest Burger King franchisee – in October. The acquisition saw BKUK's equity estate expand to 266 sites which represents 50% of the total UK estate. Alongside the acquisition, BKUK completed a £110m re-financing which will support the Brand's growth to >700 stores by 2026 (Propel).

In November, 130-site Fireaway Pizza secured £1.1m of growth funding from six investors, valuing the company at £18.7m . The company has eight master franchise agreements in Ireland, France, Holland, Canada, Australia, New Zealand, India and Pakistan (The Franchise Talk).

In early December, multi-national and multi-brand AmRest announced it had agreed the sale of its Russian KFC business for €100m to Almira – a Russian restaurant and entertainment company (Reuters).

The year's M&A closed with Barack Group of Companies, a London centric eight site KFC franchisee, complete its sale to fellow KFC franchisee The Tahir Group. The transaction saw Tahir Group become the largest KFC operator in London, operating an enlarged estate of 41 restaurants.

Other franchisors have been busy throughout 2023 – announcing a string of new franchise partners in both the UK and across international markets.

Though Pret and GDK led the charge on announcing new franchise partners, other brands saw similar success:

- In June, Itsu announced it had agreed a five year, 50-site agreement with French operator Groupe Bertrand (Propel)
- Wendy's, the third-largest QSR chain in the US announced it had signed agreements with Blank Table (a 30-site care home operator) in October to open sites across Eastern England, and Papas Hospitality Group (a 10-site fish & chip shop operator). (Propel)
- In November, Deep Blue Restaurants (Harry Ramsden's) announced it had signed an exclusive retail development license with Boparan Holdings (Propel)
- 36-site French artisan bakery and patisserie chain Paul announced it was looking to grow the brand to 100 sites by partnering with franchise operators to accelerate growth. Paul expects 50% of the estate to ultimately be owned and operated by franchisees (Propel).

WE ANTICIPATE HEIGHTENED LEVELS OF M&A ACTIVITY IN 2023 – THOUGH WE EXPECT THIS WILL INCLUDE A NOTABLE NUMBER OF DISTRESSED TRANSACTIONS IN H1.

WE'RE HOPEFUL THAT AS INFLATION PRESSURES EASE AND INTEREST RATES SOFTEN, THE MARKET QUICKLY TURNS AND TRANSACTIONS THAT WERE PUT ON ICE THIS YEAR HAVE THEIR TIME TO SHINE.


REFILL
SHOP

TIPS & TRONCS UPDATE

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HOSPITALITY SECTOR – UPDATE ON PRIVATE MEMBERS EMPLOYMENT (ALLOCATION OF TIPS) BILL

A private members Bill is proceeding through Parliament proposing legislative changes on how tips should be treated. It is not known when the Bill will become law, however it is widely expected to be within the next year or so, and could be as early as April 2023.

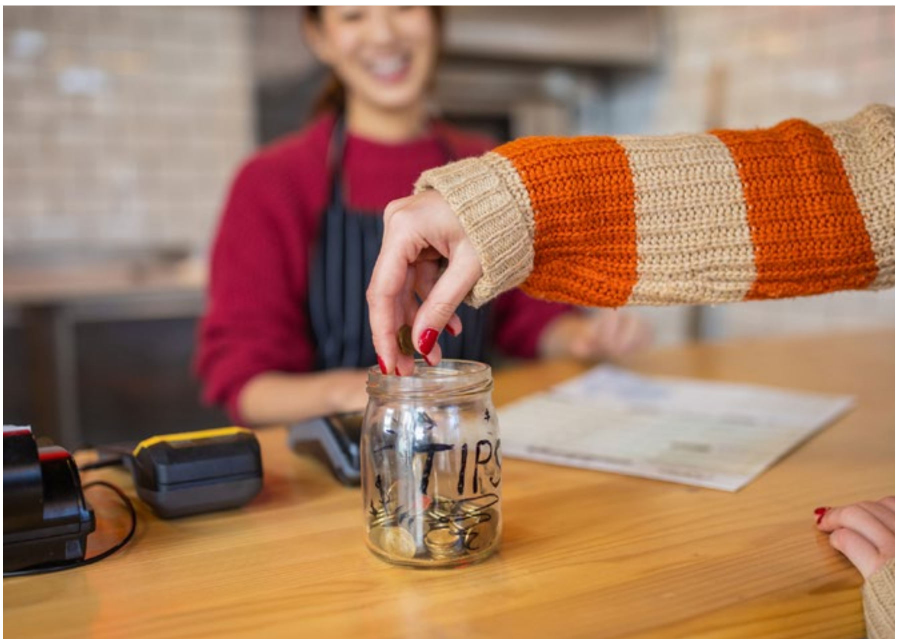
The current drafting of the Bill includes nine clauses that not only place an obligation on businesses to distribute all discretionary tips, but also a time frame in which to distribute them and a requirement to implement a policy ensuring fair and transparent distribution of tips.

The proposed changes in the draft Employment Bill cover the following areas:

- All tips, service charges and gratuities ("tips") must be paid to employees
- The distribution must be fair and transparent
- Tips paid must be paid to employees by the end of the month following the month they were paid by the customer
- Tips paid cannot be subject to deductions including for administrative fees
- The employer must retain documentation of the distributions for up to three years and provide on request
- Agency workers will be entitled to receive tips in the same way as employees
- There will be a Statutory code of practice also recognising robust Tronc arrangements
- Employees and agency workers have up to 12 months to raise a dispute through an employment tribunal.

Most businesses currently use a tronc arrangement overseen by a troncmaster to manage the allocation and distribution of tips, typically be a general manager, who independently oversees the allocation of tips and administers the arrangement. The advantage of a robust Tronc scheme is that the tips are exempt from Class 1 Employers and Employees National Insurance Contributions. Whilst an employer can have oversight of the appointing or removal of a troncmaster, a troncmaster cannot be the employer. It is also the troncmaster's responsibility to ensure tronc records are retained.

Whilst it may not be straight away that this Bill is enacted into law, now is the time to review your current arrangements and policies to ensure that they are robust and can be adapted in preparation for the new rules.



THE SUSTAINABILITY/ESG AGENDA IN 2023

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Even in the face of current economic headwinds, do pay attention to the sustainability agenda – it matters to your bottom line. As global challenges come and go, the climate & biodiversity crisis and the systemic consequences will necessitate inevitable political and economic policy responses around the world. Here are six issues you should consider:

1 ENHANCE YOUR RESILIENCE TO FUTURE DISRUPTIONS

Severe weather events such as flooding, storm damage, extreme heat and humidity will increase in both intensity and frequency. Access to and costs of capital will likely reflect your resilience to these climate scenarios. Mass migration is likely to remain a long-term trend and the risk of illegal migrants and slaves entering your value chain will increase accordingly. Be vigilant and focus on issues that matter to your business.

2 AVOID 'GREENWASHING'

Don't make claims about your sustainability credentials that cannot be supported by verifiable evidence. Regulatory authorities are taking a dim view of this form of fraud and there is considerable legal and reputational jeopardy around making false and misleading ESG statements.

3 REPORTING AND DISCLOSURE

A clear outcome from the recent climate and biodiversity COPs is the growing political support for organisations and businesses to report and disclose their environmental, social and governance (ESG) performance. The long term intent is to align financial and non-financial [sustainability] reporting in one, user-friendly annual report. Leading the charge on bringing coherence to this still-opaque space is the **International Sustainability Standards Board (ISSB)** – expect announcements about this in the coming months. When reporting and disclosing your ESG performance, prioritise the sustainability topics that matter to your business in the eyes of your stakeholders. In the hospitality sector these typically require data disclosures relating to your energy consumption, water management, food packaging and waste management, food safety, nutritional content, workforce labour practices & safety, supply chain management & food sourcing, and customer safety.

4 LOOK AT THE DATA AND ASK, 'SO WHAT?

ESG performance data with your competitors and establish a benchmark. Strong performance around the material indicators listed above will help you gain a competitive advantage.

5 COMMUNICATE YOUR ESG PERFORMANCE

Use your ESG data to create an honest, transparent and verifiable narrative about your sustainability performance. Include it in your business plan and strategy.

6 INTERNALISE AND INSTITUTIONALISE SUSTAINABILITY-THINKING

Bring everyone with you and use their ideas to improve ESG performance across your business – your investors, lenders, customers and employees will reward you accordingly.

THE SUSTAINABILITY/ESG AGENDA IN 2023 CONTINUED

REPORTING ESG PERFORMANCE

A synopsis of the information requirements to be disclosed through the ISSB's four pillars

THE 4 PILLAR REPORTING FRAMEWORK USED BY TCFD AND ADOPTED BY ISSB MEANS...

LEADERSHIP & GOVERNANCE

The governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities.

STRATEGY

The approach for addressing sustainability-related risks and opportunities that could affect the entity's business model and strategy over the short, medium and long term.

RISK MANAGEMENT

The processes the entity used to identify, assess and manage sustainability-related risks.

METRICS & TARGETS

Information used to assess, manage and monitor the entity's performance in relation to sustainability-related risks and opportunities over time.

...ENTITIES WILL DISCLOSE THEIR ESG PERFORMANCE ACCORDING TO ISSUES SUCH AS:

Leadership & Governance

- Named individual or body responsible for ESG-related risks and opportunities
- Terms of reference, board mandates and other relevant entity policies
- How the correct skills and competencies are made available
- Communication processes
- Decision process concerning ESG-related risks and trade-offs
- How the body sets ESG-related targets.

Strategy

- Significant climate-related risks and opportunities that could affect the business model
- The impact of significant climate-related risks and opportunities on the business model.
- Impact on strategy and decision-making
- The impact on its financial position
- The resilience of the entity to physical impacts and transition to a lower carbon economy.

Risk Management

- Process by which risks are identified
- Process by which the entity assesses the significance of the risks: likelihood, impact, thresholds, risk-assessment tools (SBTs) used, significant input/data parameters used, how the approach has changed compared to the previous reporting period
- How the risks are being monitored and managed
- How the climate-related risks are integrated into the overall risk management process.

Metrics & Targets

- Process by which risks are identified
- Gross Scope 1, 2 and 3 GHG emissions – expressed as tCO_2e
- Amount (%) of assets and activities exposed to physical climate & transition risks
- Proportion of revenue aligned with eco opportunities
- Amount of capital deployed towards risks and opportunities
- Internal carbon prices.
- Proportion of remuneration affected by climate-related considerations
- Disclosure of climate-related targets.

BUT ACHIEVING THIS MUST START WITH UNDERSTANDING BUSINESS OBJECTIVES AND HOW SUSTAINABILITY SUPPORTS THE CRITICAL PATH

DATA GATHERED ON MATERIAL ESG PERFORMANCE INDICATORS

ASSURED, DISCLOSED AND REPORTED

TARGETED COMMUNICATION TO RELEVANT STAKEHOLDERS TO HELP ACHIEVE BUSINESS OUTCOMES

THE SUSTAINABILITY/ESG AGENDA IN 2023
CONTINUED

MATERIAL ESG PERFORMANCE INDICATORS

Materiality topics in the dimensions of sustainability filtered through ISSB's four pillars.

DETAILED MATERIALITY TOPICS TO BE INCLUDED IN THE REPORTING FRAMEWORK...

ENVIRONMENTAL
- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts.

SOCIAL CAPITAL
- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labelling.

HUMAN CAPITAL
- Labour Practices
- Employee H&S
- Employee Engagement, Diversity & Inclusion.

BUSINESS MODEL & INNOVATION
- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing and Efficiency
- Physical Impacts of Climate Change.

LEADERSHIP & GOVERNANCE
- Business Ethics
- Competitive Behaviour
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management.

...FILTERED THROUGH ISSB'S FOUR PILLARS...

LEADERSHIP & GOVERNANCE	STRATEGY
RISK MANAGEMENT	METRICS & TARGETS

...WILL HELP IN ACHIEVING BUSINESS OBJECTIVES AND SUSTAINABILITY GOALS

DATA GATHERED ON MATERIAL ESG PERFORMANCE INDICATORS

ASSURED, DISCLOSED AND REPORTED

TARGETED COMMUNICATION TO RELEVANT STAKEHOLDERS TO HELP ACHIEVE BUSINESS OUTCOMES

BR OVERVIEW

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CONTINUED PRESSURE

Restaurants and bars have, for the most part, seen continued increases in revenues but with mounting energy and input costs, as well as continued labour shortages. The subsidy provided by lower VAT rates ended in March. As the year progressed, protections against landlord forfeiture also ended and the commercial rent arrears arbitration scheme took effect. More recently, the effects of inflation and higher interest rates have exerted pressures on consumer spending. Some operators have seen continued buoyant trading conditions, but some have inevitably seen headwinds. Like many sectors, there has been a cost-of-living crisis, as well as a cost of doing business crisis. A more volatile inflationary environment is not something we have seen for many years and maintaining margins and bottom-line profitability is a challenge.

In our recent Business Trends Analysis, which reviewed over 16,000 businesses with turnover of between £10m and £500m, 23% of businesses in the hospitality sector were identified as having a 5-year compound annual growth rate of less than 5% and an interest cover ratio, in their latest financial year, of less than 2 times. In short, some businesses in the sector are highly leveraged and are surviving simply to service their debts with little ability to invest in growth opportunities.

Amongst some of our clients, there appears to be a trend of operators in villages and smaller towns performing well as people look to stay local and perhaps tighten the purse strings. Footfall in city centres remains lower than pre-pandemic levels. Despite this, there has been some improvement, with city centre operations continuing to perform, particularly with late-night bars attracting a younger clientele who live at home and are not affected by mortgage interest rate increases, and still have sufficient disposable income to fund nights out.

Smaller businesses in the sector, who operate a single site or a small portfolio of sites and are not able to drive operational improvement or maintain margins in the same way as larger businesses may well see tougher times.

Pub numbers have continued to reduce, with many sites being acquired for alternative use, including residential development.

Over the past few years, low interest rates and government legal and fiscal support measures have significantly subsidised businesses. However, there is inevitably likely to be an increased need for restructurings in one form or another in 2023 and 2024, as the effects of the issues above begin to bite. Repayment of government-guaranteed loans and deferred tax liabilities and the ending of the energy bill relief for non-domestic customers on 31 March 2022 will not help this. Additionally, any increased level of failures in allied sectors, such as food and drink manufacturing, is likely to have a knock-on impact on supply chain and cost of sales.

BUSINESS TURNAROUND

The length and shape of this downturn appears to be uncertain and it may well be more short-lived than originally feared. Businesses in the sector will need to be more on their toes than ever to survive and thrive in the coming year. Maintaining margins and hence bottom-line profit and cash generation, as significant inflation continues to be seen throughout the cost structure will be challenging. Each business in the sector will have a different point at which the customer's attitude to price increases causes a loss of revenue, for example in reduced covers and/or spend per cover. This will be a delicate balance to maintain.

Failure will inevitably create opportunities for those that can continue to weather the storm and adapt. For those with investment capital available, there will no doubt still be opportunities to expand portfolios in key locations, potentially hitting the ground running with a fitted-out and fully staffed site.

CLARITY

In addition to vigilance on the revenue/cost side, management need to be more aware than ever of the balance sheet and cash flow dynamics. Sound financial management is critical. Upcoming regulatory and other changes and deadlines are also key.

Focus remains high on the Environmental Social Governance (ESG) agenda and customers are showing an increased level of awareness of, and desire for, locally sourced and ethical products. Many brands are already paying attention to this strong sentiment and are beginning to adjust their business models to meet these demands. There is also growing political pressure for businesses to report and disclose their ESG performance.

RESTRUCTURING

The Corporate Insolvency and Governance Act of 2020 ('CIGA') introduced some powerful debtor-led restructuring processes, allowing the company to remain in control to a higher degree than ever. This represented a significant change in the UK restructuring regime.

A level of protection from creditors is available by way of Moratorium protection as they seek to restructure. There is also a Restructuring Plan, a powerful means of compromising creditor claims in some cases. Traditional restructuring tools such as Company Voluntary Arrangements also continue to be available and are particularly relevant to restaurants, bars and pubs.

Use of these newer tools remains generally relatively low to date, albeit we have begun to see their application in the mid-market and it is likely that more businesses will seek to use them to restructure their debt and/or leasehold property portfolios as 2023/2024 progresses.

As with all effective restructuring tools, early intervention is critical in order to allow time to create a viable and sustainable financial and operational restructuring plan.

FURTHER READING ON THE GOVERNMENT RESTRUCTURING TOOLS CAN BE FOUND HERE AND IN RELATED LINKS.

BDO SECTOR EXPERTISE

RESTAURANTS, BARS AND PUBS

Our national Restaurants and Bars team comprises industry specialists across audit, tax, and advisory. We offer expertise tailored to your business, and can resolve unique challenges that arise within the sector.

We are recognised as the leading adviser to the Restaurants and Bars sector, blending sector knowledge and experience with practical advice that is aimed at making a real difference to your success.

With a focus on the mid-market and private equity, we frequently advise entrepreneurial businesses as they grow, and offer commercial insight that is founded on sector expertise.

With our dedicated transactional team bolstering our audit and tax services, we are able to advise your hospitality business throughout its full life cycle.

As thought-leaders across the sector, we offer specialised commercial and technical updates, and we have a well-established network in the industry that spans finance directors, suppliers, and advisers. We are always willing to use everything at our disposal to our clients' advantage.

LEISURE AND HOSPITALITY

As well as restaurants and bars, our wider team has expertise across the hospitality and leisure sectors, with industry-focussed teams in retail, hotels, travel and tourism, betting and gaming, and professional sports.

We have a breadth and depth of expertise across each of these industry segments, and we provide business and risk assurance, tax planning, corporate finance assistance, performance improvement advice, and personal wealth management to our clients.

CONTACTS

We hope that you enjoyed this report.

For more information on our sector credentials, or to receive our thought-leadership reports in any of our other Leisure and Hospitality sectors, please get in touch.

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