IDEAS | PEOPLE | TRUST

Catering for success

Restaurants and Bars Report 2024

The Restaurants and Bars Report 2024

For the last few years, the UK restaurant industry has been heavily impacted by factors beyond operators' control, and 2023 was no different.

It was another challenging year across the sector, with stubbornly high inflation, rising interest rates, the cost-of-living crisis and geopolitical tensions increasing pressure on both businesses and customers.

However, our industry is nothing if not resilient.

In this year's report we reflect on what the key challenges are for the future of the sector, and how consumers and operators are responding. We look back at 2023, reviewing deal flow and consumer trends to find opportunities and look forward to changes in 2024.

Contents

Introduction from Mark Edwards	3
Priorities for the year ahead	4
Market and Consumer Overview	4
Deals Overview	10
Raising Debt	16
Homelessness and Hospitality	17
Business Insurance Claims	19
Tips & Troncs Update	21
Headwinds and Opportunities	23
BDO Sector Expertise	24
Contacts	25

Introduction from Mark Edwards

Partner and Head of Restaurants and Bars

Welcome to the 2024 edition of our annual Restaurants and Bars report: A focused insight into consumer behaviour and trends in the sector.

Once again I write the introduction to this report inspired by the continued achievements of so many in our sector. The ability to adapt to changing conditions whether caused by supply chain challenges, macro-economic impacts, changes in consumer behaviour including their location of work, or industrial action on our transport networks has been prevalent throughout 2023.

While the December trading figures, especially in the crucial third week, were positive, it would be wrong to suggest that confidence is universally creeping through the sector. While we may have cautious optimism about falling inflation and interest rates, the reality remains that input prices and labour costs are materially higher than 2019 and so it feels like trading records need to be broken just to stand still in terms of conversion to Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA). Free cash flow is then also challenged with materially higher borrowing costs.

What will 2024 have in store then? While we have attempted to offer some suggestions, I am fully aware that the year could offer more questions than answers as we navigate economic, political and labour force changes over the coming year.

I remain optimistic, however, that operators are more skilled than ever before at dealing with challenges to trading and as always, I expect innovation to be at the forefront over the next 12 months, through necessity and the sector's desire to improve and fight for every discretionary pound available.

We are delighted to be able to support you as you navigate the challenges and opportunities of 2024 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 2024 and beyond.

Mark Edwards
Partner
Head of Restaurants and Bars

Priorities for the year ahead

Without doubt, last few years have been exceptionally challenging and while we hope for some stability over the coming year or so, a focused boardroom agenda is a must to survive and grow during volatile trading conditions. Here are the key topics we believe should be on the agenda:

A sustainable green plan

With the Labour party refining its green plan by ditching its commitment to spend £28bn a year on the green economy, there has been a sharper focus on what "being green" really means. While we are aware that ESG credentials (covering, of course, not just environmental issues) are key for some lenders and investors, there is a focus on where the value is being driven – is it in consumer spending, value enhancement (or lack of erosion) or in the ability to finance operations?

Without doubt though there are two key areas to be aware of – firstly, any commitments to environmental targets need to be well thought through as failing to meet agreed targets is likely to attract negative attention. Secondly, there is increasing focus and attention in both mass media and regulatory circles about green washing and we anticipate the negative publicity linked to this to be significantly damaging if businesses get caught up in it.

An increasingly fragmented market

We all love poring over data. Luckily, thanks to the number of providers willing to report, there is lots about. The reality is it's never really about having data, what you do with it. We are seeing already, and we anticipate this will increase over the coming year, the fragmentation of our market – different behaviours exhibited by Generation Z (Gen Z) compared to Millennials compared to Baby Boomers and differences in geographical locations, between cities, towns, and villages. While the temptation will always be to try and appeal to as many markets as possible, this risks not really appealing to anyone and so working out not only who are your customers, but as pertinently, who are your customers that deliver your EBITDA and who can enhance it is key.

Pricing is profit

There has been no choice but for prices to increase given the inflationary pressures that the sector has incurred and with the national minimum wage increasing in April there will be more pressure on prices. There must be a point, however, where prices are capped – not least if headline inflation is falling to around 2% by Spring. The market feels like we have reached the natural elasticity on pricing where trading down, spending less per visit, or worse, staying at home, is a reality which becomes habit – and one that is hard to break. Discounting to demonstrate value is a dangerous strategy at the best of times, but driving business into venues will see novel uses of space, more special events and price bundles. We anticipate that dynamic pricing (reductions rather than commonplace surge pricing) will become more common but in reality, it is bundling rather than discounting that will drive traffic.

Changes in consumer behaviour

There are a variety of trends which are emerging and being tweaked since our release from lockdowns and then the economic pressures which followed the Ukraine conflict and the Truss/Kwarteng mini-budget. For example, the increasing use of cash allowing consumers to budget more effectively, the return of workers to offices (and we anticipate this increasing more and more as the economic conditions in the professional service sector in particular become more challenging), the increasing number of health conscious individuals (including the reduction in drinking), the preference for craft over cask. We also note, that premiumisation appears to have stuck as a habit and expectation, but this is leading to some volume erosion – as ever focusing on getting a pound out of an existing customer is a lot easier than winning a new one so really understanding the impact of these changes in behaviour is key.

Being ready to capitalise on positive news

The risk of the above is that they tend to focus on challenges rather than opportunities. In reality though, we believe that there could be a strong end to the year. If the stars align then over the next 12 months, we could see interest rates fall, energy costs declining, headline inflation back on target, a good long summer and even potentially a post election new government bounce. The deal market is already anticipating a better year ahead for transactions, and we believe the momentum is going to build steadily as confidence grows in the sector and its ability to adapt to make the most of the improving conditions. Being well placed to make the most of the opportunities ahead should not be forgotten!

Market and consumer overview

The cost-of-living crisis was a prevailing theme in the UK throughout 2023. Both businesses and consumers alike navigated a challenging year of record inflation driving high levels of cost and reducing the overall purchasing power on both sides. Despite the challenging environment, some brands managed to adapt and thrive. As forecasts trend to a more positive 2024, BDO's Strategy team recaps the year and highlights key themes through observations and analysis of the hospitality sector.

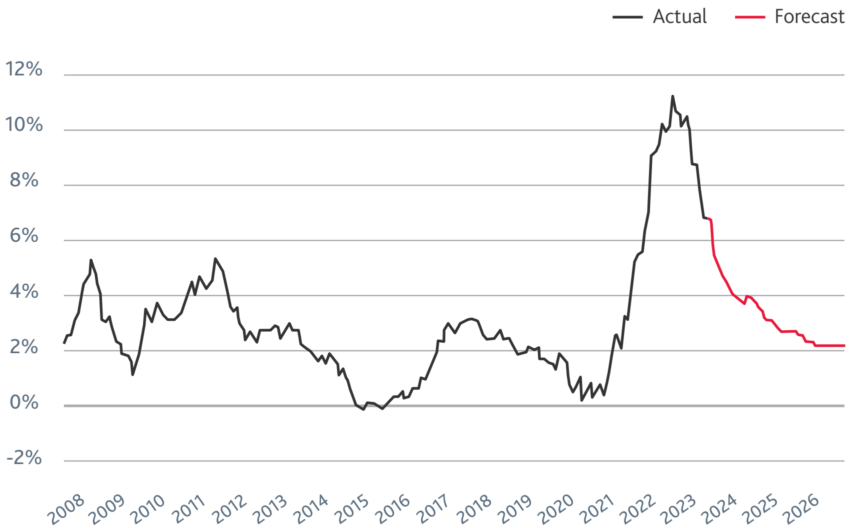
Tom Holt
Partner, Strategy & Commercial Due Diligence
+44 (0)73 8593 3809
tom.holt@bdo.co.uk

Tushar Chadha
Associate Director, Strategy & Commercial Due Diligence
+44 (0)79 7095 7956
tushar.chadha@bdo.co.uk

Economic drivers

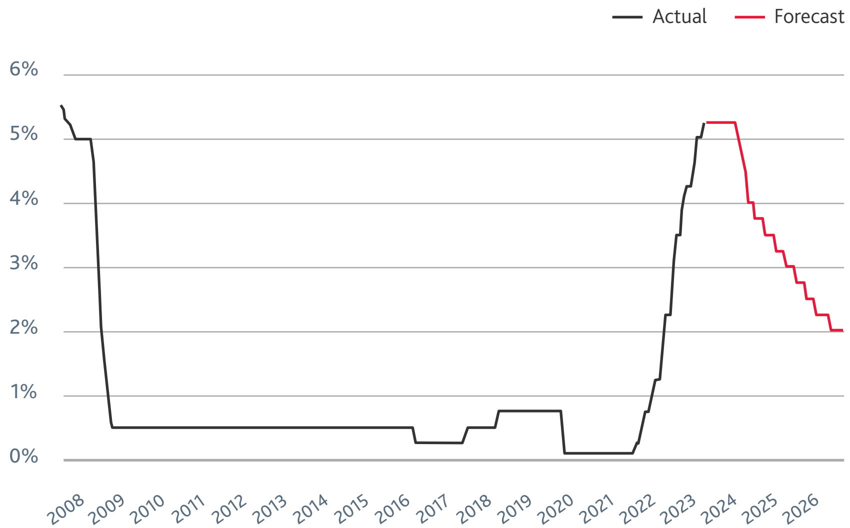
Inflation is expected to continue to drop, but there is still considerable headroom before it reaches target levels.

Consumer price inflation



Interest rates are expected to remain stable through 2024, with an eventual reduction from Q4 onwards.

Bank of England base rate



The UK appears to have weathered the peak of the cost-of-living challenge with inflation stabilising at a more palatable 3.5%. However, forecasts for 2024 suggest a period of sustained high interest rates, which may lead to a recession during Q1 of 2024. This is likely to continue to put a strain on the purchasing power of the UK consumer. For the hospitality sector, this means that the upcoming year will be one of more fierce competition as brands try to compete for the diminished levels of consumer spend.

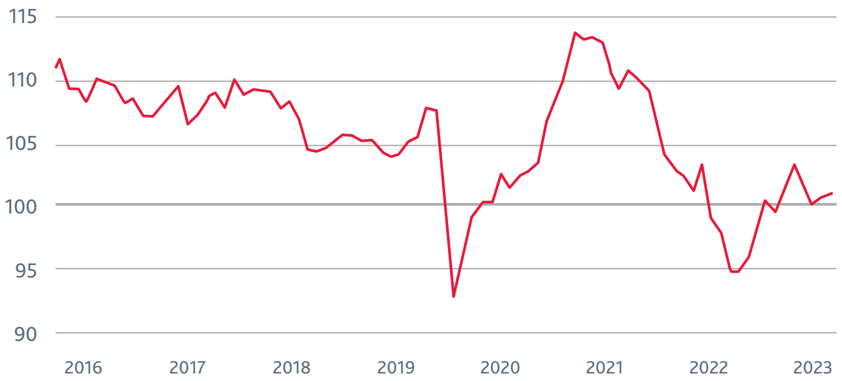
Market and consumer overview

Consumer behaviour drivers

The high inflationary environment has created behaviours akin to an hourglass economy where the premium and value end of the market receives the most traction, squeezing out the middle-income spending patterns. Successful brands have used the current economic climate to re-engage with their core customer base and reaffirm their value proposition that initially propelled them to success. Alternatively, new entrants into the market are strategically targeting distinct pockets of consumers (by generation, income or by a combination of the two) to cultivate a dedicated following.

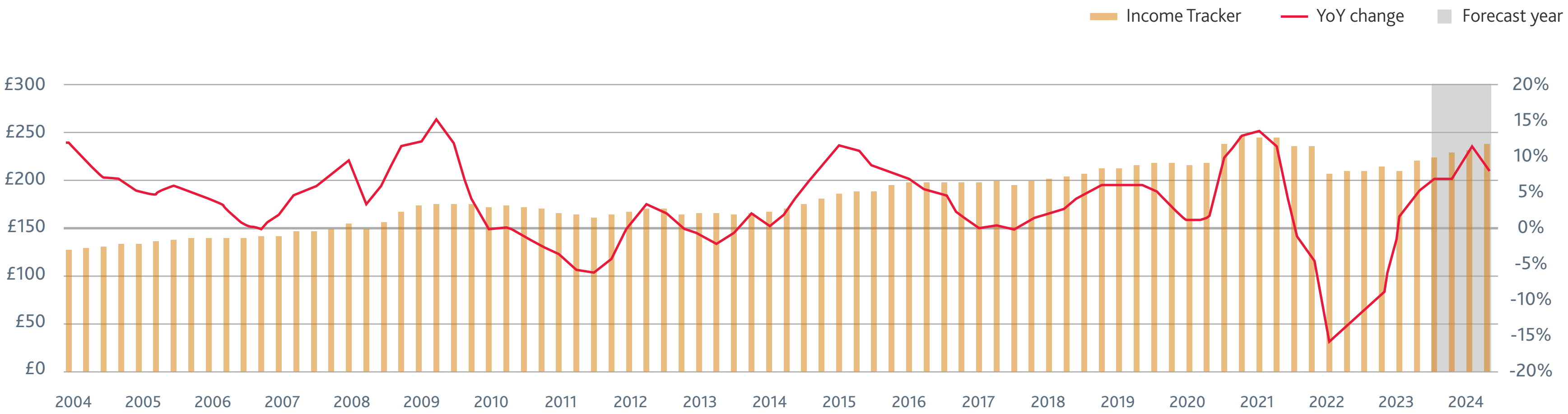
Consumer confidence Index

Axis value is 100. A score of <100 represents a negative score; a score of 100 represents a neutral score of >100 represents a positive score.



Consumer confidence remained volatile through 2023, but the overarching movement has been favourable. The prospect of fiscal certainty for consumers, when coupled with easing cost-of-living pressures, may lead to a more buoyant start to the year than observed in recent times.

Asda income tracker



Household disposable income remains below levels observed pre-2023, which will continue to be the hospitality sector's main challenge for the upcoming year as consumers look to stretch the value of each pound spent.

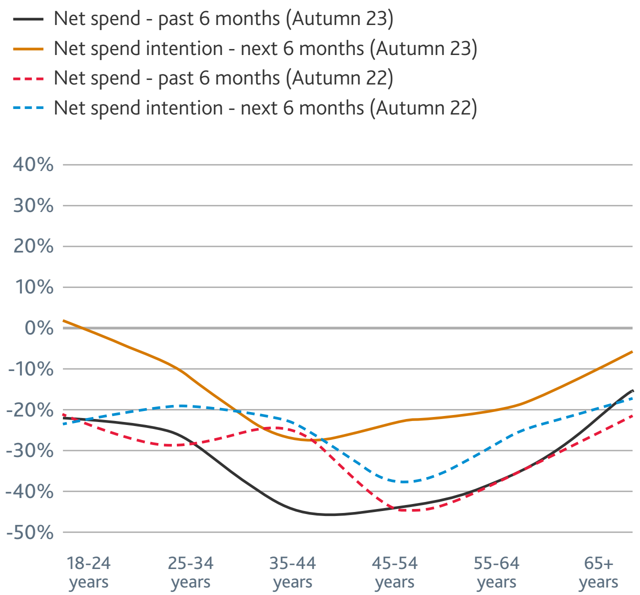
Market and consumer overview

Consumer trends

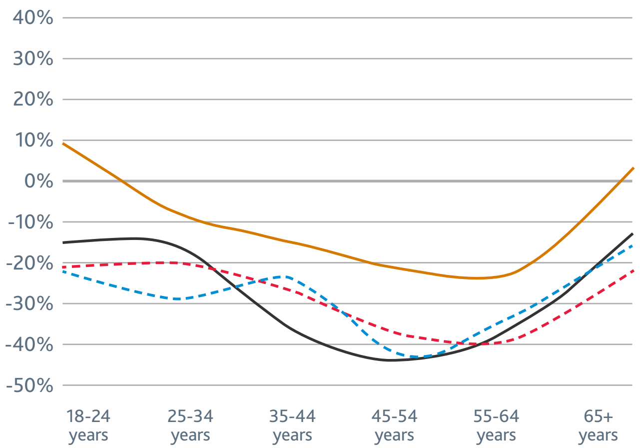
BDO's seasonal consumer study reveals a positive shift in the sentiment towards drinking and eating out between Autumn 2022 and 2023. This is particularly evident when comparing anticipated spending over the next six months. This positive trend bodes well for sector operators as they look to 2024, resonating with key economic factors such as consumer confidence and household disposable income.

There's still potential for growth across all age groups, particularly within the 35-64 demographic, where there's a significant opportunity to enhance sentiment. This scenario offers businesses a crucial opportunity to develop and execute strategies specifically tailored to re-engage this key segment of the UK market.

Drinking out



Eating out



Demographic	BDO Survey insights	Business considerations
18–24	The 18–24 age group is the only demographic that exhibits a net positive sentiment towards eating and drinking out in the next six months. The rising cost of overseas travel has shifted preference to more domestic leisure & hospitality activities, presenting a notable opportunity for businesses in the sector.	**Prioritising the experience:** 44% of this demographic prioritise leisure and experiences over product purchases highlighting the importance of tailoring marketing strategies to emphasise the experiential aspect of dining and drinking establishments.
35-44 **45-54**	The ongoing strain from elevated interest rates and rental prices is negatively influencing the spending behaviours of these demographics. Specifically, 50% of those aged 35-44 and 47% of individuals aged 45-54 are expressing concerns due to these categories of expenditure.	**Re-engage through value:** As interest rates are expected to remain elevated through the majority of 2024. Implementing targeted promotions and cost-effective offers can serve as effective tools to mitigate the impact of high interest rates on consumer spending patterns. Businesses should consider tailoring discounts to specific needs and preferences of this demographic such as family discounts.
55-64	The sentiment of approximately 80% of this demographic has been affected by the rise in grocery prices and utility costs. However, with a downward trend in inflation, there is an observable improvement in sentiment as we head into 2024.	**Entice through loyalty:** With expectations of inflation continuing a downward trend in the coming months, businesses should consider the imminent opportunity of increased spending within this demographic. By creating enduring loyalty through tailored rewards, and personalised incentives, businesses can not only alleviate the impact of past financial strains but also cultivate heightened interest in their proposition.

Market and consumer overview

To tackle economic challenges and navigate the evolving consumer landscape, brands are deploying cost optimisation and revenue-boosting strategies to gain a competitive edge. While not necessarily groundbreaking, when executed effectively, these strategies have delivered noteworthy outcomes throughout the year.

Revenue focused | Cost focused

Revenue focused	Cost focused	Strategies businesses are exploring	Brand spotlight	
Introducing loyalty programs		Brands are looking to boost customer loyalty with the promise of future discounts and rewards to drive higher spend frequency and value. BDO's Consumer Trends survey found 20% of consumers looking to cut back spend on eating and dining out plan to use loyalty programmes.	PRET	Pret's revamped loyalty scheme has boosted turnover 20% (H1) and seen average transaction value up 30%.
Experiential dining/socialising		Enhancing the atmosphere with activities or design to differentiate and grow the value perception.	BIG MAMMA	Big Mamma Group have built value perception through fun and social media worthy interiors and energetic service.
Targeting suburban locations		To overcome capital constraints and adverse rent to revenue ratios, businesses have de-risked their site roll out strategy by moving to suburban locations. Along with cost savings, this has also introduced brands to consumer segments and improved levels of repeat purchases.	megan's	Megan's has consistently targeted suburban locations and have built a community of loyal customers with concepts such as community nights and live music. The operator recently reported its strongest Christmas on record, 19.3% like-for-like sales growth and has lined up four openings for this year, remaining on track to deliver £30m in revenue.
	Convenience formats	Smaller site offerings such as takeaway or dark kitchen formats for budget and convenience led customers.	wagamama	Wagamama's return on capital for dark kitchen has ranged between 35-40% for 2023, driven by the lower CAPEX requirements.
	Tech enabled solutions	Introducing tech solutions in front and back of house, to reduce reliance on labour and increasing cross/up-selling opportunities.	YO! sushi	YO! Sushi have a fully integrated tech system, reducing labour requirements and differentiating the customer experience.

Market and consumer overview

About the strategy & commercial due diligence consumer team

Our experienced Strategy & Commercial Due Diligence Consumer team has worked with major players across the hospitality sector. Key to our success is our ability to understand the UK consumer and their dining and leisure habits, and how these will impact the modern restaurant and bar concepts of today.

Our hospitality-focused services include:

- 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

Access to our seasonal consumer sentiment tracker and other thought leadership articles can be **found here**

Deals overview

Positivity is on the horizon for the UK restaurants and bars sector with inflation falling, interest rates stabilising, and a strong return in deal activity. In a remarkable turn of events, two of the UK's leading restaurant groups, Fulham Shore and The Restaurant Group, announced they will be exiting the UK listed market, following offers from international trade and private equity buyers respectively. In the pub sector, which has had a challenging year, there was one notable deal that stood out - the acquisition of AIM-listed City Pub Group by competitor Young & Co's Brewery plc. December saw yet another take-private deal with the acquisition of bowling operator Ten Entertainment by Trive, a Texas-based private equity firm.

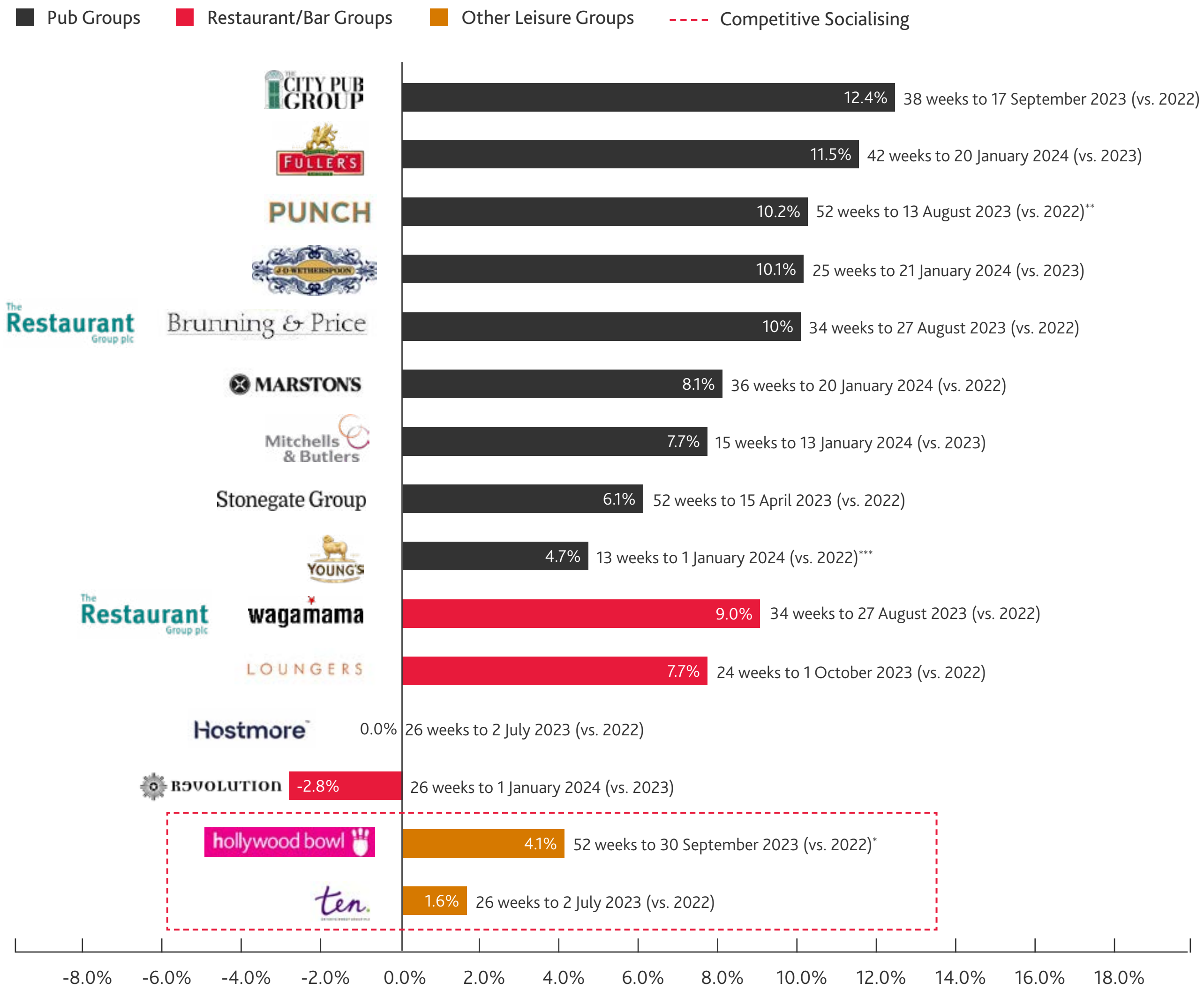
Harry Stoakes
Partner, M&A
+44 (0)77 8557 6325
harry.stoakes@bdo.co.uk

Yashna Gopal
Senior Manager, M&A
+44 (0)78 7026 0256
yashna.gopal@bdo.co.uk

2023 started with some stark numbers – 10% inflation rate, 17% food inflation rate, 3.5% interest rate. These figures worsened during the year but showed promising signs in the last quarter. Despite the challenging consumer environment, R&B operators were able to grow their top-line revenue by implementing price rises and managing volume carefully. The like-for-like (LFL) sales analysis (Chart 1) shows most operators reported positive LFL sales in the year. However, they continually faced cost pressures from a number of directions – food, energy and wages.

Chart 1: LFL sales

Source: Company Trading Updates



*Hollywood Bowl Group UK division only. LfL of Canada division is +15.1%.
**Punch Pubs Group is revenue growth rather than LfL sales growth.
***Youngs LFL growth is their managed division only.

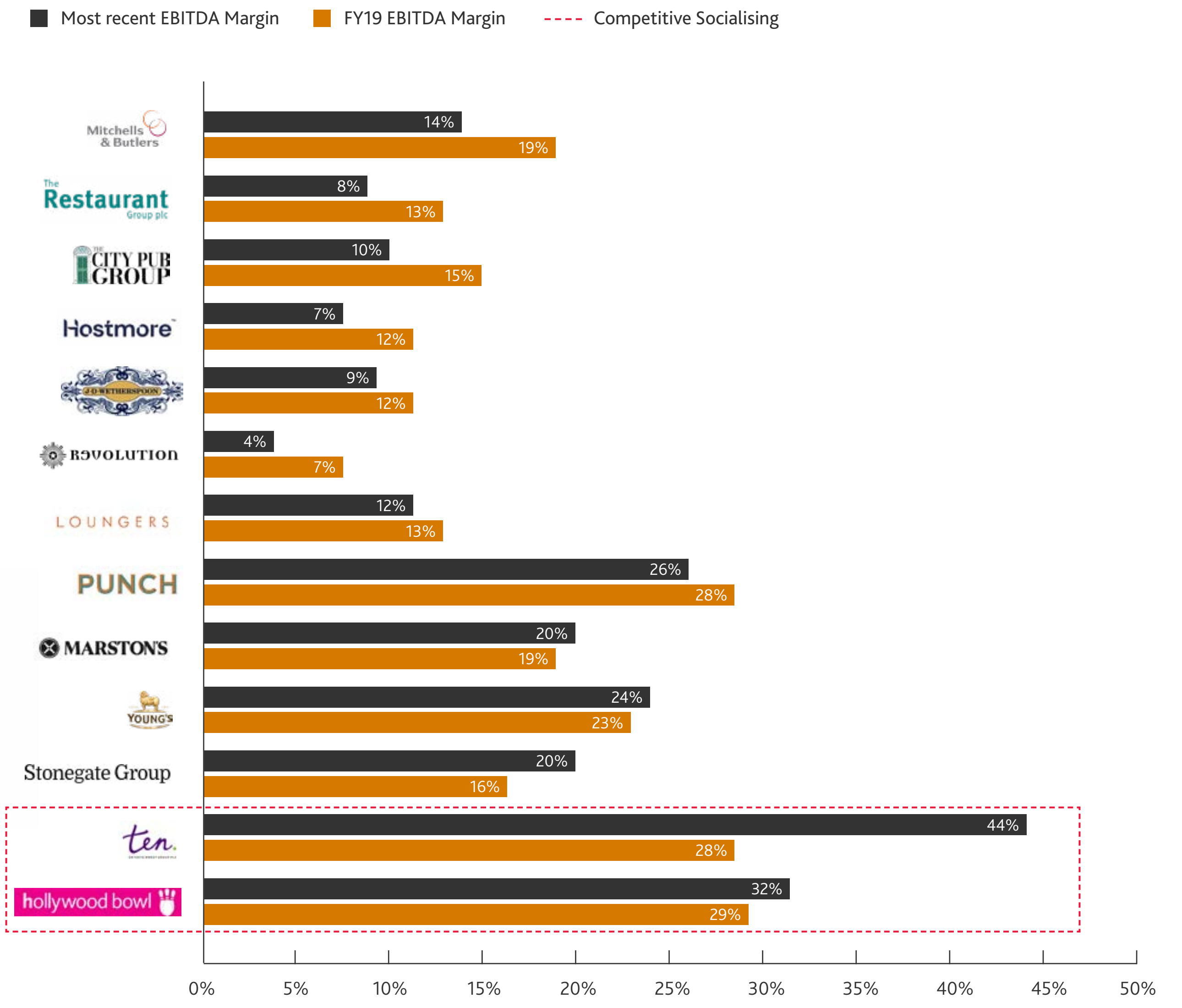
Deals overview

Our analysis of key sector operators' margins shows that most operators have been able to hold their gross profit (GP) margins to pre-COVID-19 levels, by passing on increases in food and beverage costs to consumers. However, the decline in EBITDA margins compared to pre-pandemic levels has been evident, as shown in Chart 2 opposite.

Players in the competitive socialising space such as Ten Entertainment and Hollywood Bowl, which benefit from substantial incremental profit from additional sales of high-margin activities, have seen their EBITDA margins rise in this period. The realm of experiential leisure and competitive socialising, beloved by
Gen Z, is continuing to thrive, marked by a steady influx of fresh and innovative concepts introduced every year. 2023 saw the introduction of F1 Arcade, a Formula 1 racing simulation experience venue and TOCA Social, an immersive football and dining experience venue. These concepts add to a growing list of experiential leisure operators in the UK such as Flight Club, Clays, Bounce, Swingers, NQ64, and Puttshack. Most competitive socialising businesses are currently backed by investors such as Edition Capital and Imbiba which actively pursue new leisure deals. We expect that sub-segment to be at the centre of M&A activity over the next couple of years as more brands emerge in this growing landscape and existing investors look to realise their investments. Pub operators, who have been experiencing declining EBITDA margins, will surely discover the attractiveness of the competitive socialising brands that have proved that they are not just a short-term trend but long-standing, profitable businesses commanding margins double those of pubs.

Chart 2: Latest EBITDA margin v/s pre-COVID-19

Source: BDO Research, Companies House

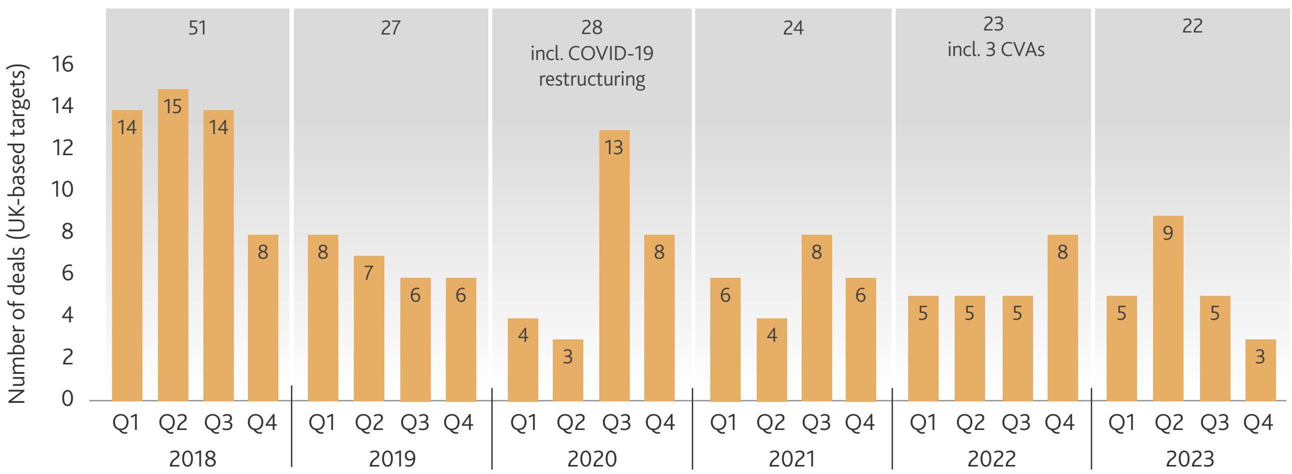


Deals overview

Pub deals in 2023 were scarce, with some large operators bringing portfolios of sites to the market to rationalise their estates. There was significant activity in the restaurant sector, which has seen heightened interest from international and private equity buyers.

Chart 3: Hospitality M&A deal count by quarter, 2018 – 2023

Source: MergerMarket, BDO Intel



Deals overview

2023 started with the news that Stonegate was planning to offload 1,000 pubs, representing a fifth of its pub estate, for an estimated £800m to pay down its £3bn debt pile.

The most notable pub deal of the year was the sale of 50-site City Pub Co. (CPC) to Young & Co's Brewery in November 2023, valuing the pub group at £162m. Shareholders of CPC received 75% of the consideration in cash, with the remainder as shares in Young's. 60% of the group's sites are freehold assets, with a 2022 independent valuation valuing 17 of its properties at £98m. In the lead-up to this deal, CPC sold 5 of its sites to Portobello Starboard in March 2022, and increased its shareholding in Mosaic Pub Group to 52% in April 2023, taking over its operations. The sale announcement disclosed that CPC had head-office costs of £5.6m and that the deal would generate GP savings of 3pp, which BDO estimates to be worth £1.7m. Given its FY22 adjusted EBITDA of £8.0m, we estimate that the deal value 10.6x site EBITDA.

The 2022 Edition of our Restaurants and Bars report highlighted the low valuation of both TRG and Fulham Shore, which has been the source of frustration for both management teams and sector investors. Both companies have since received takeover offers from international players. All the deals represented a premium of at least 30% of the previous day's share price and premiums on the average share price in the last year. However, CPC and The Restaurant Group (TRG)'s share prices on take-over were below the average pre-COVID-19 share price.

Table 1: Analysis of share prices of listed operators taken private

Source: S&P Capital IQ

	Ten Entertainment	City Pub Co.	The Restaurant Group	Fulham Shore
Announcement date	06 Dec 2023	16 Nov 2023	12 Oct 2023	05 Apr 2023
Acquisition price per share (p)	4.09	136.00	65.80	13.90
Share price 1 day pre-announcement (p)	3.10	99.00	48.35	10.50
v/s acquisition price per share	32%	37%	36%	32%
Avg. Share price 1 year pre-announcement (p)	2.80	85.82	39.22	11.74
v/s acquisition price per share	46%	58%	68%	18%
Avg. Share price 1 year pre-COVID-19* (p)	2.53	208.33	136.57	11.33
v/s acquisition price per share	62%	-35%	-52%	23%

*Mar 2019 - Feb 2020

Deals overview

The lion's share of M&A deals in the sector in 2023 was in the restaurant space, with strong interest from overseas buyers.

2023 started with private equity firm TriSpan's acquisition of Indian casual dining group Mowgli, providing an exit with a 3.5x money multiple for Foresight, which had invested £3.45m in 2017. Founder Nisha Katona has maintained a significant interest in the company and will continue as group chief executive.

In April 2023, Fulham Shore, which operates the Franco Manca and The Real Greek restaurant brands, announced that it would be acquired by Toridoll Holdings Corporation, in a deal valuing the business at approximately £93m. Japan-based Toridoll operates Marugame Udon, Shoryu and Wok to Walk in the UK in partnership with private equity firm Capdesia. The acquisition price represented 7.5x of its FY22 Adjusted Headline EBITDA of £12.4m, which includes the reduced VAT benefit.

In the same month, global investment platform Mohari Hospitality announced its acquisition of Tao Group, the restaurant and late-night entertainment group which owns brands such as TAO and Hakkasan, from MSG Entertainment. The transaction valued Tao Group at $550 million, which represented estimated 8.2x its FY22 adjusted operating income.

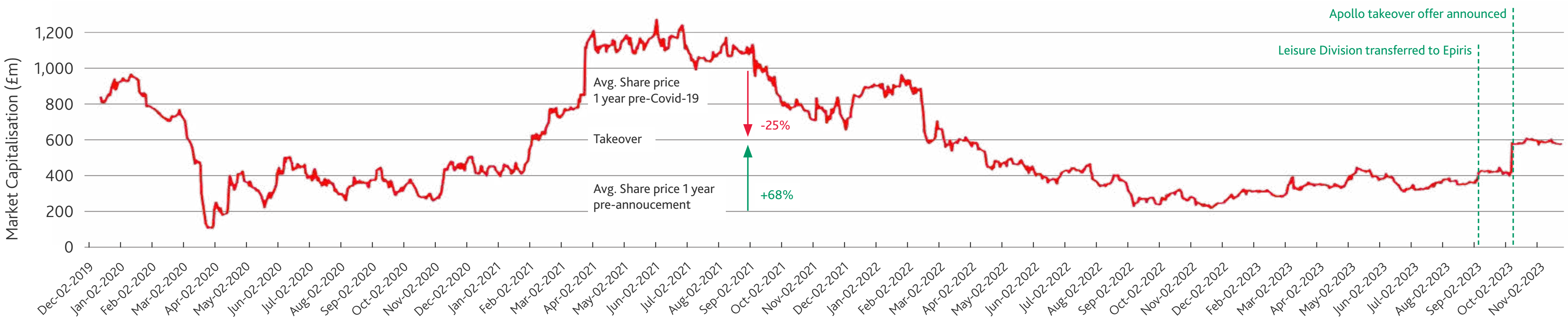
In September 2023, McWin, the private equity firm founded by Henry McGovern and Steven K. Winegar, acquired a majority stake in Big Mamma, the Italian-cuisine restaurant group founded by two French entrepreneurs. Big Mamma has a portfolio of 23 restaurants across five European countries and was valued at €270m.

In the same month, The Restaurant Group (TRG) announced an agreement to transfer its loss-making Leisure Division, consisting of Frankie & Benny's and Chiquito, to the Big Table Group, which is backed by the private equity house, Epiris. Although TRG paid £7.5m to Big Table for this transfer, the market received the news positively and its share price increased 7% on the announcement. A carve-out of this nature had long been anticipated by the market, especially following the huge pressure from Hong Kong-based investor, Oasis Management, which had been calling for a shake-up for months.

Weeks later, it emerged that that deal was a minor procedure ahead of a more significant intervention. TRG announced it had received a £506m offer for its shares from US buyout group Apollo, which would take it private. The deal valued the group at £701m, representing 9x of its LTM EBITDA. The acquisition value was deemed soft by many analysts, considering the value of the group's Wagamama brand, one of the UK's best restaurant brands, which was itself valued at £559m on acquisition in 2018. There is also c.£160m of freehold value from the Brunning & Price pubs within the group.

Chart 4: Market Capitalisation of The Restaurant Group plc, 2019 – 2023

Source: S&P Capital IQ



Deals overview

On the quick service restaurant (QSR) front, M&A activity was relatively quiet with only a couple of transactions throughout 2023 until December when EG Group, the largest KFC franchisee in Western Europe, announced the sale of its UK&I KFC estate to Yum Brands (KFC brand owner). Papa Johns International also acquired the UK sites from Drake Food International, its largest international franchisee.

Asian QSR brand Chopstix led the first deal in the QSR space in 2023 with its acquisition of 27-site competitor Chozen Noodles which operates in motorway service areas, for c.£2.4m. The acquisition brings the total size of the Chopstix estate to 127 sites.

In June, Papa John's International acquired 91 restaurants previously operated by the franchisee Drake Food Service International, its largest international franchisee. The acquisition will allow Papa John's to operate its first company-owned sites in the UK, which it expects to use as test sites for operating enhancement initiatives.

EG Group, the largest KFC franchisee in the UK and Ireland, announced that it had agreed to sell its entire 218-site estate in the UK and Ireland to Yum Brands' KFC division. The transaction is expected to complete in the first half of 2024. No financial terms were disclosed in the announcement. KFC GB previously embarked on a refranchising strategy across their UK estate and this latest deal would suggest a reversal of that strategy.

Conclusion

For a long time, there has been frustration around suppressed valuations in the UK listed markets. 2023 was an interesting year to see international investors and buyers start to exploit that gap. We expect this trend to continue, with more take-private transactions in the restaurants and pubs space this year, until valuation multiples recover.

The slowdown in pub M&A activity in the year comes as no surprise – many pub operators have been focused on upgrading their existing estates and ensuring they are able to deliver rewarding experiences to their customers. They are also facing growing competition from competitive socialising operators for discretionary consumer spend. Pub groups will need to re-invigorate their offering to adapt to the evolving needs of the younger generation, who are reducing their alcohol consumption and attribute more value to experiences. Introducing paid activities within pubs will not only provide an additional income source but will also increase dwell times and further bolster the food and beverage income stream.

We anticipate that large international investment firms and leisure operators will recognise the vast potential in the competitive socialising space in the UK. They will seek to turbocharge growth through investments and consolidation, and also take the successful concepts globally.

Sustainability & ESG Thinking in Exit Strategies

In the face of regulatory and inflationary pressures, an emphasis on sustainability & environmental, social, and governance (ESG) performance is now a long-term strategic necessity, not just a passing trend. Traceability in long, complex supply chains — particularly those that carry material environmental risks, such as the land and water footprints of sourcing meat — is a fundamental precursor to operational sustainability. A shortening and digitalising of supply chains would not only better weather global disruptions but also drive value: companies that improve their ESG scores tend to experience an EV/EBITDA multiple greater than the associated net financial costs of green investment, including in the services and consumer goods sectors.

Consumer preferences will also inevitably shape exit strategies. 40% of consumers report that they would prefer to drink at a venue committed to net zero by 2030, and 59% actively consider a beverage's environmental credentials before buying — up from 56% in 2021, despite the ongoing cost-of-living crisis. Operators looking to exit the sector in the next decade must recognise that ESG is not just a nice-to-have; it is essential for safeguarding future value and reducing risk, and it is here to stay.

Edward Sell
Business Analyst
+44 (0)77 1216 3643
edward.sell@bdo.co.uk

Raising debt

When a restaurateur is juggling the competing demands of rising fuel bills, higher costs of raw materials, a cost-of-living crisis, staff shortages and rising rents, they might be forgiven for not devoting too much headspace to those in the banking community. But while conditions for raising debt are better than any time in the last four years, a business owner must be properly prepared if they are to raise the best terms.

Steve Carr
Managing Director
Debt Advisory
+44 (0)79 7094 8777
steve.carr@bdo.co.uk

With COVID-19 lockdowns firmly in the past, restaurants can now see a clear picture of their earnings unaffected by pandemics, bounce-backs or government support schemes. Likewise, lenders can put their trust in the numbers, making them more likely to want to back the winners in the sector. Not that every lender is open for business. There are some lenders who are hesitant, perhaps looking across their portfolios at businesses still struggling to recover from such unprecedented events. But others have backed the sector, with OakNorth's support of TriSpan's investment in Indian casual dining group Mowgli catching the eye.

Despite the turmoil of the last few years, the restaurant sector offers a great product and service to UK consumers. The public increasingly wants memorable experiences and Instagram moments, and restaurants can deliver those in bucketloads. But turning great experiences for consumers into a great business that lenders will want to support requires not just a differentiated concept or a gold-leafed steak – it needs a great management team.

So, what does a management team need to do to raise debt?

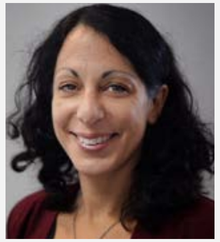
Lenders love financial data. It helps them to overcome questions from their credit committee members. If they can tell a story to their credit committee about a differentiated offering and display a management team on top of their finances, lenders can be more persuasive in the heat of battle with Credit. For example, data showing strong trading, including like-for-like growth in sales at existing sites, an ability to manage margins despite increasing costs, and positive cash generation from each site will all help to convince a sceptical banker they are looking at a management team at the top of their game.

For those wishing to raise debt to expand the number of sites, understanding how well previous site openings have performed (and the return on capital employed) is crucial. If a lender can see a track record of successful historical sites and understand how quickly the initial investment turns into profits and cash, they may be more easily persuaded to back a future site roll-out. Lenders will also want to see lease terms and the extent of fixed costs in the business to understand how vulnerable a business might be to a wobble in trading.

The other factor to consider is to find the right lenders to approach - those with appetite for the sector and the right size of business. This is where getting the right advice can really help to find that pocket of liquidity. Typically, when you go to market you get one chance to get it right. It isn't easy to turn a "no" to a "yes", and bankers have long memories. But lenders are out there for the right businesses, and especially the best management teams.

Homelessness and hospitality

The UK is experiencing a homelessness crisis with rough sleeping and the use of temporary accommodation at record highs. Rough sleeping is the most visible and dangerous form of homelessness, but living in temporary housing, hostels and B&Bs are incredibly damaging to individuals too. The impact of homelessness is stark.



Emma Haddad
Chief Executive Officer,
St Mungo's

Josh Trott
Corporate Partnerships Manager,
St Mungo's
josh.trott@mungos.org

The average age of death for a man experiencing homelessness is **45**.
For women it is just **43**.

The latest statistics highlight the scale of the crisis:

- There was a 23% increase in rough sleeping in England in the past year, with 4,389 people seen sleeping rough in Greater London between October-December 2023
- 2,283 people were rough sleeping for the first time, a 34% increase on the same figure this time last year.

The causes that push someone into homelessness are complex, but the cost-of-living crisis and severe shortage of affordable housing are creating a 'perfect storm' and pushing more and more people into homelessness. It is a trend we expect to continue.

Homelessness and the hospitality sector

Homelessness and the hospitality sector intersect, with customers and colleagues seeing the impact of rising homelessness in both their personal and professional lives, undoubtedly seeing homelessness in its most extreme form as they travel to and from work or when socialising.

Your colleagues and employees could be placed in situations where they need to have difficult conversations with people who are rough sleeping, without the knowledge or skills to do this in a constructive and positive way.

Research commissioned by St Mungo's found that people working in the gig economy, including in hospitality, were at greater risk of homelessness than in other sectors. With rising rates of homelessness, it is likely that there could be hidden homelessness either within your business or your supply chain.

Both employees and customers are becoming more socially aware, and social responsibility is driving both greater brand loyalty and greater staff retention. A recent study found that 78% of people think it is important that brands have a strong sense of community, and in another study 53% would not work for an employer they thought to be unethical.

St Mungo's
Ending homelessness
Rebuilding lives

About St Mungo's

Our mission is to end homelessness and rebuild lives. We envision a society where everybody has a place to call home and can fulfil their hopes and ambitions.

Since 1969, we've been at the forefront of efforts to tackle homelessness. No two experiences of homelessness are the same. That's what makes our holistic approach so important, and why our range of services is so broad.

We support people from rough sleeping into emergency accommodation, before finding somewhere safe for them to call home and to begin their recovery from homelessness. This could include mental health support, training to develop new skills or employment advice, but each of our client's journeys are unique and we tailor our support to meet their specific needs.

Homelessness and hospitality

How St Mungo's can help the hospitality sector

St Mungo's has a track record of building innovative, bespoke partnerships with leading businesses from a range of sectors to help support people experiencing homelessness and move us closer to our vision of ending homelessness for good. Ways in which we have supported restaurants and bars include:

Recruitment

Retaining and recruiting talent is an ongoing challenge for the hospitality sector, which has been particularly affected by the wider labour shortage issues in the economy. Having a job is a vital step in someone's recovery from homelessness and we know that 62% of our clients want to work, but currently only 7% do. Meaningful employment provides so much more than a salary; it provides a social network, a purpose, confidence, and improved mental health.

St Mungo's works with a wide range of businesses to create employment pathways for our clients, where both our clients and the employer feel fully supported to make the opportunity a success. A career in hospitality could help our clients to leave homelessness behind for good, all whilst helping to address a major challenge your business likely faces.

Training

Transient workers and those in the gig economy are some of the most vulnerable to homelessness. There is also a lack of skills, knowledge, and expertise in where to go for support when it is needed, or how to identify people most at risk of homelessness within a business. To create a better understanding of the complexities of homelessness, St Mungo's developed 'HomelessWise' training in collaboration with, and for, the business community.

'Homelesswise' training helps to:

- Provide management with insights to help identify those most vulnerable to homelessness from within a business, and the knowledge to notice the risk factors associated with homelessness
- Equip relevant teams with the skills and confidence to support colleagues experiencing homelessness effectively and compassionately
- Give practical advice for public-facing teams, such as security, facilities management, or front of house to have constructive and empathetic conversations with homeless people they may encounter.

Simply put, 'HomelessWise' training will improve your knowledge and understanding of homelessness and provide real-life guidance on how to approach engaging someone who is experiencing homelessness. It ensures that both your colleagues and anyone experiencing homelessness feel respected in their interaction and able to have difficult conversations in a supportive way.

Engaging your customers

As customers continue to become more socially conscious, they make purchasing decisions based on how businesses approach their environmental and social responsibilities. St Mungo's has a track record of engaging customers through our partnerships with businesses and we would work alongside your teams to tell compelling stories to your customers and create ways for them to engage with our partnership.

St Mungo's
Ending homelessness
Rebuilding lives

"Meeting Grace (Employment Advisor at St Mungo's) really was life-changing – for the better. I'd never thought about working in food or hospitality – I was in construction before. But I sat down with Grace and thought, what could I do.

Grace helped me get an interview with Le Manoir, and then I got the job! It felt unreal when I got it. I didn't expect it at all. The people there really saw the person within and saw my potential.

I can't really believe it, where I am now. I have just recently come off anti-depressants, as it felt like it was my time. And I'm now really feeling like myself again. And a lot of that is down to St Mungo's."

Chris, St Mungo's client

Business interruption insurance claims

Although COVID-19 is to a large extent in the rear-view mirror, the repercussions are still being felt by many. The UK's hospitality sector remains front and centre in the ongoing struggle to get business interruption insurance claims paid almost four years since the start of the pandemic.

Paul Hope
Director, Forensic Accounting & Valuation Services
+44 (0)74 0789 0788
paul.hope@bdo.co.uk

Although COVID-19 is to a large extent in the rear-view mirror, the repercussions of it are still being felt by many, and the UK's hospitality sector remains front and centre in the ongoing fight to get business interruption insurance claims paid; more than four years since the start of the pandemic

The sector was one of the hardest hit, with restaurants, pubs and bars being some of the first words to pass the Prime Ministers lips when he first raised the spectre of mandatory closures and lockdowns in March 2020. Even after the restrictions had been lifted, changes in customer behaviour, staffing issues and supply chain disruptions continued to impact revenues and costs. Exacerbated by rising interest rates, rocketing energy prices and general price inflation, this has left many hotels, restaurants, pubs, and bars struggling to stay afloat, and others having to close their doors permanently.

As with other sectors, many hospitality businesses take out insurance cover against the risks of interruption to trading. Policy coverage varies widely but, in general, business interruption coverage is linked to the 'property damage' section of the policy; meaning that for the business interruption policy to respond there has to have been some physical damage to the insured property (e.g. in the case of a fire, flood or other unforeseen event). However, policy extensions are available (typically at an increased premium) to cover additional 'non-damage' risks, such as supply chain issues, diseases, or hindrances in access to business premises.

As one would expect, many hospitality businesses quickly took the insurance policy out of the filing cabinet and notified their insurers of claims. The problem was that COVID-19, and the government's response to it, was (to use a word we heard all too often) "unprecedented", and it was unclear if, how and to what extent the policies provided cover.

Faced with a deluge of claims, many insurers took the initial stance of denying cover, much to the consternation of hundreds of thousands of policyholders, a large proportion of which were in the hospitality sector, facing significant cashflow issues.

Due to the magnitude of the issue, in June 2020 the Financial Conduct Authority (FCA) stepped in, using its powers as regulator of the insurance industry to bring an expedited case (based on a representative sample of policy wordings) to the High Court in July 2020. The judgment was handed down in September 2020, appeals (from both the FCA and insurers) heard in November 2020 (leapfrogging the Court of Appeal and going directly to the Supreme Court), with final decision handed down in January 2021. This process was the first use of the 'Financial Market Test Case Scheme' - unprecedented issues called for unprecedented legal procedures!

The FCA Test Case provided some much-needed relief for impacted businesses when it established that (contrary to many insurers' initial positions) the wide vicinity/radius 'diseases' extensions in many business interruption policies (whereby there must be an instance of a covered disease within a specific radius of the insured premises) should provide coverage for pandemic-related losses, as should 'denial of access' clauses in certain circumstances. However, it still left a lot of issues remaining to be clarified.

Business interruption insurance claims

For example, it did not determine fact-specific issues such as whether claims could be made for multiple separate instances of loss or the amount that should be paid in particular cases.

Since then, there have been several high-profile court cases, heavily featuring hospitality sector businesses (for example Corbin & King (now 'The Wolseley Hospitality Group'); Stonegate Pub Company; Greggs; and Various Eateries), which have explored further significant policy coverage issues with broad relevance to the hospitality sector, such as:

- Further nuances to coverage under 'denial of access' clauses
- Whether policy claim limits apply on a 'per premises' basis, or across the group
- If and how events should be 'aggregated' for the purposes of determining how many separate claims a business can make (which is relevant to the application of individual claim limits)
- Whether or not credit for the benefit of the insurer should be given in the claims for receipts of government assistance, such as furlough payment support – a key issue for the hospitality sector where employment costs are a significant proportion of overall expenses.

Since those decisions, there have been further legal cases exploring other key issues, such as that of the London International Exhibition Centre (owners of the ExCel conference centre in London), which established that policies providing cover for diseases 'at the premises' should essentially respond in the same way as the 'wide vicinity/radius' disease clauses which were the subject of the FCA Test Case, which could potentially affect hundreds of thousands of policyholders.

Whilst the outcomes of these cases appeared to provide some much-needed clarity for businesses and insurers, many of the key issues decided at first instance were to be the subject of appeals by claimants or insurers (for example the method of aggregation, and the deduction from claims of furlough), although some appeals have since been abandoned, with both Greggs and Stonegate settling with their respective insurers during 2023 on undisclosed terms.

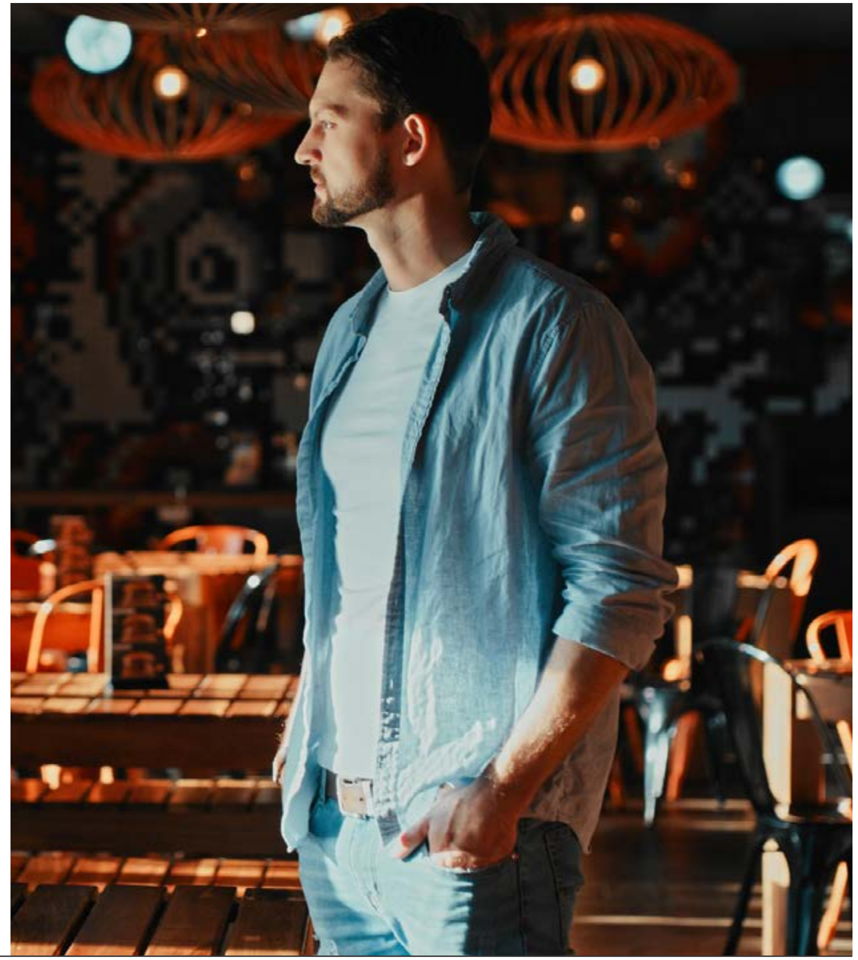
January 2024 saw judgment being handed down in the Various Eateries appeal, with the Court of Appeal confirming the earlier decisions of the High Court, meaning essentially that policyholders can claim for multiple loss periods, aggregating around certain government restrictions, albeit only where restrictions become worse (i.e. mere extensions or relaxations of existing restrictions do not trigger a new claim).

January 2024 also saw the outcome of several test cases against Liberty Mutual, again featuring claimants in the hospitality sector (for example Fuller Smith & Turner, and Hollywood Bowl Group). Seen as largely a success for policyholders, in brief, the court found that the UK Government is a "statutory authority" within the meaning of the 'denial of access' clause, and that the limit of liability applies separately to multiple insured entities under a 'composite' policy. However, consistent with the earlier finding in Stonegate, the court decided that insurers are entitled to take the benefit of furlough payments received by policyholders. At the time of writing, expectations are that the furlough issue will be taken to the Court of Appeal later in 2024.

It should be noted however that each of the cases since the FCA Test Case have been litigated on their own specific facts, and there remain many other issues at present untested (for example the question of damages resulting from late payments by insurers causing consequential losses to policyholders).

What help is available to the hospitality sector?

It seems fair to say that this all leaves the current state of claiming and quantifying business interruption claims as a complex one. There are many different forms of insurance policy wording, and every business will have faced its own specific set of challenges. But help is available, from specialist forensic accountants with experience of complex business interruption claims.



Tips & troncs update

John Chaplin
Partner, Global Employer Tax Services
+44 (0)77 6727 4436
john.chaplin@bdo.co.uk

Cheryl Thomson
Senior Manager, Global Employer Tax Services
+44 (0)75 8306 3895
cheryl.thomson@bdo.co.uk

The Allocation of Tips Act received Royal Assent on 2 May 2023. The Draft Code of Practice on Fair and Transparent Distribution of Tips has now been issued alongside HMRC opening a consultation for comments from employers which closes on 22 February 2024. Non-statutory guidance will be issued in due course as it is confirmed the Act will come into force from 1 July 2024 to help affected employers to operate best practice.

The Framework is expected to encompass the Statutory Code of Practice, setting out the finer points of the new rules, and so you might be reluctant to make too many changes until the consultation is concluded, but there are many practical changes you can be looking at implementing in advance.

Whilst an extension to 1 July 2024 might be welcome news for businesses who are not yet at a stage where their tips and tronc schemes fully reflect the new rules, more proactive businesses can use the potential delay to ensure that changes fully reflect the needs of the employees and the business. So, rather than sit and wait, what can you do in the meantime?

What should an employer be doing now?

One key change is that employees will be entitled to receive 100% of tips made by customers, without any deduction, except in very limited scenarios e.g. for deduction of income tax. It is important that this is communicated to employees in a way that makes it clear to them what their allocation is and that it flows transparently through to their payslip. If you currently retain part of any service charge, for example, you may need to review your entire remuneration package for qualifying staff if you want to avoid a significant increase in pay levels and a reduction in company income.

The finer points setting out how tips must be paid to employees will not be clear until the Framework is published but, as a minimum, we expect the following headlines to apply:

1. **All tips, service charges and gratuities ("tips") must be paid to employees (including cover charges, mandatory service charges and discretionary tips).**
   - As a result, you may need to amend any employment contracts, Tronc scheme rules and even the split between contractual pay and tips etc. How will you communicate this to employees? How will any changes impact your NMW calculations?
   - If you have a Tronc scheme, the changes required will need the buy in of any Troncmaster/Committee. You will need to maintain the independence of the scheme to avoid unnecessary NIC liabilities.
2. **The distribution must be fair and transparent**
   - Tronc scheme documentation and any policies on tips may well need amending so that it easy for all employees to follow and understand.
   - Tips can no longer be shared between multi-site businesses. Employees who regularly work between sites to cover busy or slow periods must be aware of the impact this may have on their tip allocation.
   - Do your current records make it easy to calculate payments per site and feed this into payroll in time?
   - You may need to phase in any changes over time so be clear on what changes are needed for joiners versus current employees and when everyone needs to be on the same terms when the legislation "goes live."

Tips & troncs update

3. **Tips paid must be paid to employees by the end of the month following the month they were paid by the customer (e.g. a tip received from customer on 15 October must be paid to the employee by 30 November)**
   - Will this leave you enough time to record, calculate and pay tips? Will your payroll calendar need amending?
   - If you have a Tronc, do you have a clear process setting out on how the Troncmaster summarises all tips received and issues instructions to the payroll team to facilitate the payments within the reporting deadline?

4. **Agency workers will be entitled to receive tips in the same way as employees**
   - If you engage agency workers, you should discuss with those agencies how both parties will deal with the payment and taxation of tips (including Troncs). If the agency is to pay the tips on your behalf, you will need to ensure that they are paid in accordance with the new rules, and you may wish to check this occurs. Will the agency agree to provide with this information?
   - If agency workers do not currently participate in tips, do you need to communicate the changes to your employees who may now receive a smaller allocation?

5. **Employees and agency workers have up to 12 months to raise a dispute through an employment tribunal.**
   - You should have a clear process in place for handling employee queries and disputes quickly and efficiently, and make sure that employees understand how to raise any questions to help prevent unnecessary claims made direct to the Tribunal.

In short, these changes represent a significant shift for many hospitality businesses. However, if approached carefully, far from being a risk to your business, they might represent an opportunity for you to be an employer of choice.

As the draft Code of Practice has now been issued you should be reviewing the operation of your tips and Troncs and consider how you will implement any change necessary. Do not underestimate just how complex they are, how many parts of your business they might affect and just how long they will take to bed in.

Headwinds and opportunities

Alistair Rolland

Managing Director, Business Restructuring

+44 (0)74 0782 7053

alistair.rolland@bdo.co.uk

Scott Bebbington

Senior Manager, Business Restructuring

+44 (0)75 5357 7231

scott.bebbington@bdo.co.uk

Headwinds

The last several months have been especially challenging for restaurants and bars. Many of the issues we are seeing now are not new – they are sustained headwinds that the sector has been facing for the last 12 to 18 months. The sector has been particularly impacted by the cost-of-living crisis which has made consumers more price-sensitive and frugal in their spending habits.

Many companies continue to adopt hybrid working policies - however, workers are increasingly being encouraged back into the office and this has provided some welcome relief for town and city-centre restaurants and bars. Footfall across the sector is steady, however, disposable income remains low compared with pre-2023 levels. In the short-term, we expect that consumers will continue to stretch the value of each pound spent.

Many restaurants and bars accrued substantial amounts of debt during COVID-19 due to the national lockdowns – such as bounce back loans, Coronavirus Business Interruption Loan Scheme (CBILS) and even HMRC arrears. During COVID-19, Government-backed loan schemes and forbearance from HMRC provided a vital lifeline for many businesses, however, these debts do need to be serviced and the current environment is making that increasingly more difficult. Base-rate increases, leading to increased debt servicing costs, are also further depleting cash which might otherwise be put towards debt reduction.

Access to capital, either from incumbent or new funders, continues to be challenging and we are seeing many funders adopting a more risk-averse approach to the sector. With fewer options available, restaurants and bars face paying higher rates which is simply not sustainable for many.

Perhaps unsurprisingly, we have seen a 66% increase in the number of pub and bar insolvencies in the last 12 months - with 725 registered corporate insolvencies in the 12 months to September 2023, compared to 438 in the prior year. It is, however, worth noting that the 12 months to September 2022 did include a period of temporary restrictions on the use of winding up petitions and landlord forfeiture proceedings, which suppressed insolvencies generally.

Opportunities

Looking ahead, it is difficult to pinpoint exactly when the myriad of pressures will ease for restaurants and bars. In the Autumn Statement, the Chancellor confirmed that business rates relief (representing a discount of up to 75% of annual rates, capped at £110k) will be extended for a further 12 months to March 25. This will be a welcome announcement for many restaurants and bars and will provide additional breathing space.

In the short-term, we encourage Management teams to undertake a detailed review of the key drivers and take robust actions to ensure their businesses are resilient for the medium to longer-term. Restaurants and bars typically have a simple working capital cycle. Whilst there may be opportunities for some businesses to negotiate better credit terms with suppliers to provide more breathing space (particularly larger operators with more bargaining power), achieving sustainable positive cashflow mostly centres around getting the trading fundamentals right - pricing, margin and overheads.

At present, the key lever for many restaurants and bars is their cost base. Keeping a tight rein on cost is a key control for all businesses (no matter the sector) but this is even more critical during periods of adversity. 'Quick wins' may be helpful in the short-term but, headwinds will ease in time, so management teams need to be mindful of the longer-term implications of any cost rationalisation measures. This is a balancing act - in essence, businesses need to be lean but also agile and ready to react to changes in the market.

Accelerated M&A activity in the sector has been lower than anticipated, however, we expect this will increase over the next year. Restaurants and bars with cash reserves or access to growth capital are well positioned to benefit from these 'bolt on' opportunities.

Communication with key financial stakeholders such as funders or, in some cases, HMRC is also important during periods of stress or distress. We are seeing that such stakeholders are more inclined to work collegiately with Management teams if regular communication is maintained, key issues are flagged early and turnaround plans are clearly articulated.

The trading environment remains challenging for the industry, but there does appear to some light on the horizon. Inevitably, not all businesses in the sector will survive, but those that are able to weather the storm should be ready to seize the opportunities that lie ahead.

Our sector expertise

Restaurants, bars and pubs

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

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.

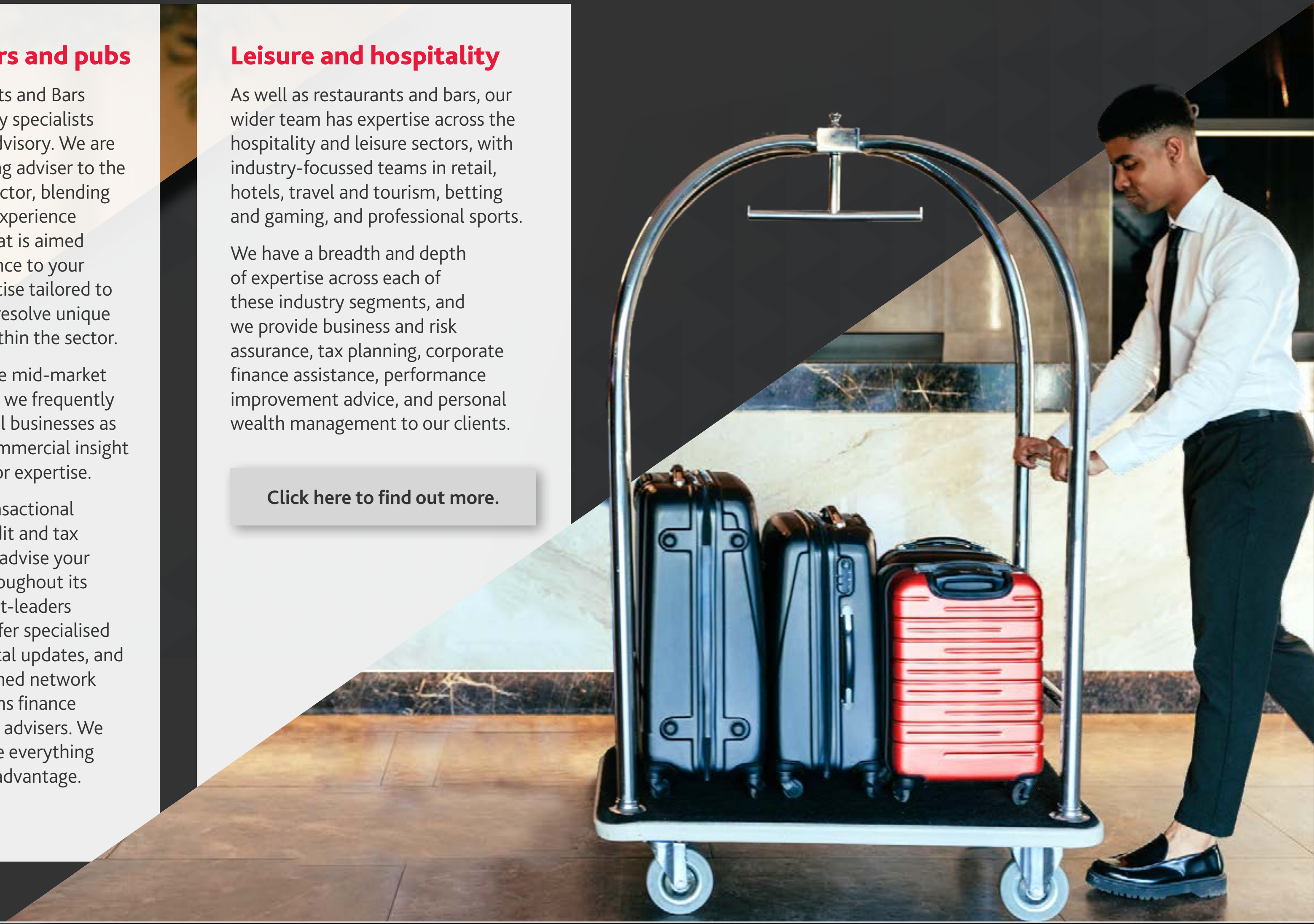
With our dedicated transactional team bolstering our audit and tax services, we are able to advise your hospitality business throughout its full life cycle. As thought-leaders across the sector, we offer specialised commercial and technical updates, and we have a well-established network in the industry that spans finance directors, suppliers, and advisers. We are always willing to use everything at our disposal to your 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.

Click here to find out more.



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.

Mark Edwards
Partner & Head of Restaurants and Bars

+44(0)20 7893 3742
+44 (0)78 0068 2917
mark.edwards@bdo.co.uk

Harry Stoakes
Partner, M&A

+44(0)20 7893 2307
+44(0)77 8557 6325
harry.stoakes@bdo.co.uk

Tom Holt
Partner, Strategy & Commercial Due Diligence

+44(0)20 7486 5888
+44 (0)73 8593 3809
tom.holt@bdo.co.uk

Martyne Pearson
Partner, Indirect Tax

+44(0)20 7893 3218
+44 (0)79 7002 3325
martyne.l.pearson@bdo.co.uk

Conor Lambert
Partner, Transaction Services

+44 (0)20 7893 2191
+44 (0)79 6859 4374
conor.lambert@bdo.co.uk

David Campbell
Partner, Audit

+44 (0)20 7486 5888
+44(0)77 7161 3951
david.campbell@bdo.co.uk

Tim House
Coo, ESG Advisory

+44(0)20 7486 5888
+44 (0)77 7646 7671
tim.house@bdo.co.uk

Mark Shaw
Partner, Business Restructuring

+44(0)20 7486 5888
+44 (0)78 8762 6280
mark.shaw@bdo.co.uk

Ed Green-Wilkinson
Partner, Audit

+44 (0)20 7893 3749
+44 (0)79 7619 8204
ed.green-wilkinson@bdo.co.uk

Jonathan Hickman
Partner, Tax

+44 (0)20 7893 2496
+44 (0)77 4776 7644
jonathan.hickman@bdo.co.uk

Jacqui Roberts
Director, Employment Tax

+44(0)20 3219 4062
+44 (0)79 8935 6240
jacqui.roberts@bdo.co.uk

Natasha Patel
Director, Corporate Tax

+44(0)20 7893 3684
+44 (0)79 7619 8458
natasha.patel@bdo.co.uk

FOR MORE INFORMATION:

Mark Edwards

Partner & Head of
Restaurants and Bars

mark.edwards@bdo.co.uk

www.bdo.co.uk

24-01-3719