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Changing tastes

The UK casual dining market

September 2017

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Outlook for the UK casual dining market

We expect challenging times ahead for casual dining operators impacted by cost pressures at the same time as consumers face a squeeze on disposable incomes. However, changes in consumer tastes and the way diners engage with restaurants, alongside increasing use of technology, provide opportunities for growth if properly harnessed

The UK casual dining sector is going through a challenging period with margin pressures mounting as a result of higher labour costs, higher business rates and increased food costs. At the same time, consumer confidence is falling, with inflation and sluggish wage growth beginning to squeeze disposable incomes.

Notwithstanding the challenges facing the sector, we see some key consumer trends emerging that casual dining operators can capitalise on in order to prosper in the current environment. These include a desire for more healthy eating, informal and experiential dining experiences, as well as increased consumer focus on food provenance and sustainability.

The use of digital technology is also increasingly impacting across the whole of a restaurant's operations. We believe the "restaurant of the future" will use technology throughout the customer journey, whether it be to provide delivery and pre-ordering services, or to connect to consumers in-store to offer customisable menus and dynamic pricing.

We look forward to discussing our views on the sector and how we are best placed to assist you.



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“Consumers want to dine on their terms. In light of the current pressures facing the casual dining sector, it's essential that operators optimise location, occasion and channel in a connected and authentic way.”

Nielsen Harrap, Senior Manager, Customer & Channel Analytics Casual Dining Lead

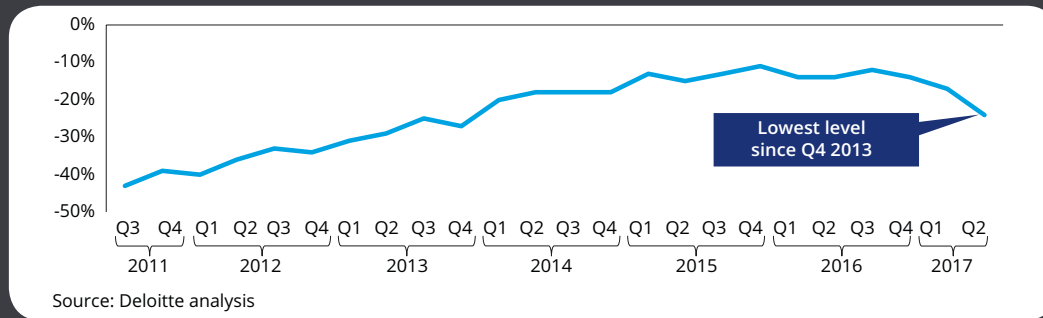


Consumer confidence outlook

Our analysis shows a fall in consumer confidence in 2017 impacting negatively on consumers' appetite for discretionary spend. This will directly impact the casual dining sector, which is experiencing a fall in like-for-like sales growth rates

Consumer confidence about level of disposable income

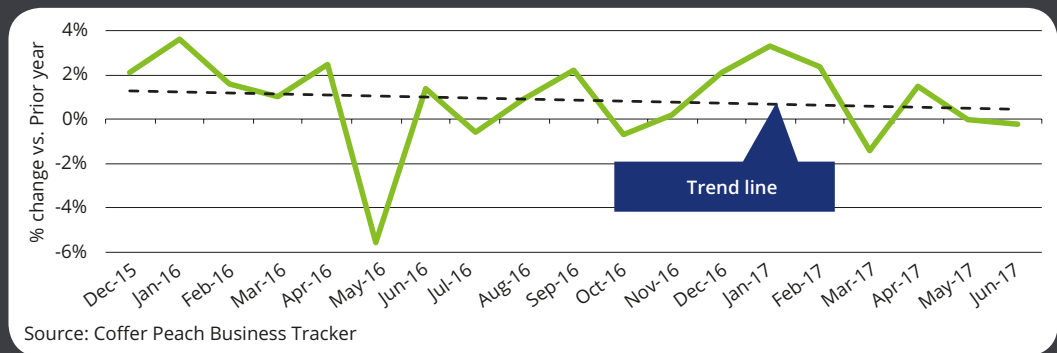
Net % of UK consumers who said their confidence about their level of disposable income has improved in the past three months



- The latest Deloitte Consumer Tracker shows a further fall in consumer confidence in 2017, a sign of rising cost pressures emerging in the consumer economy.
- Since the EU referendum spending has been holding up well, but with inflation rising and nominal wage growth starting to slow, consumers are beginning to feel a squeeze on their disposable income.

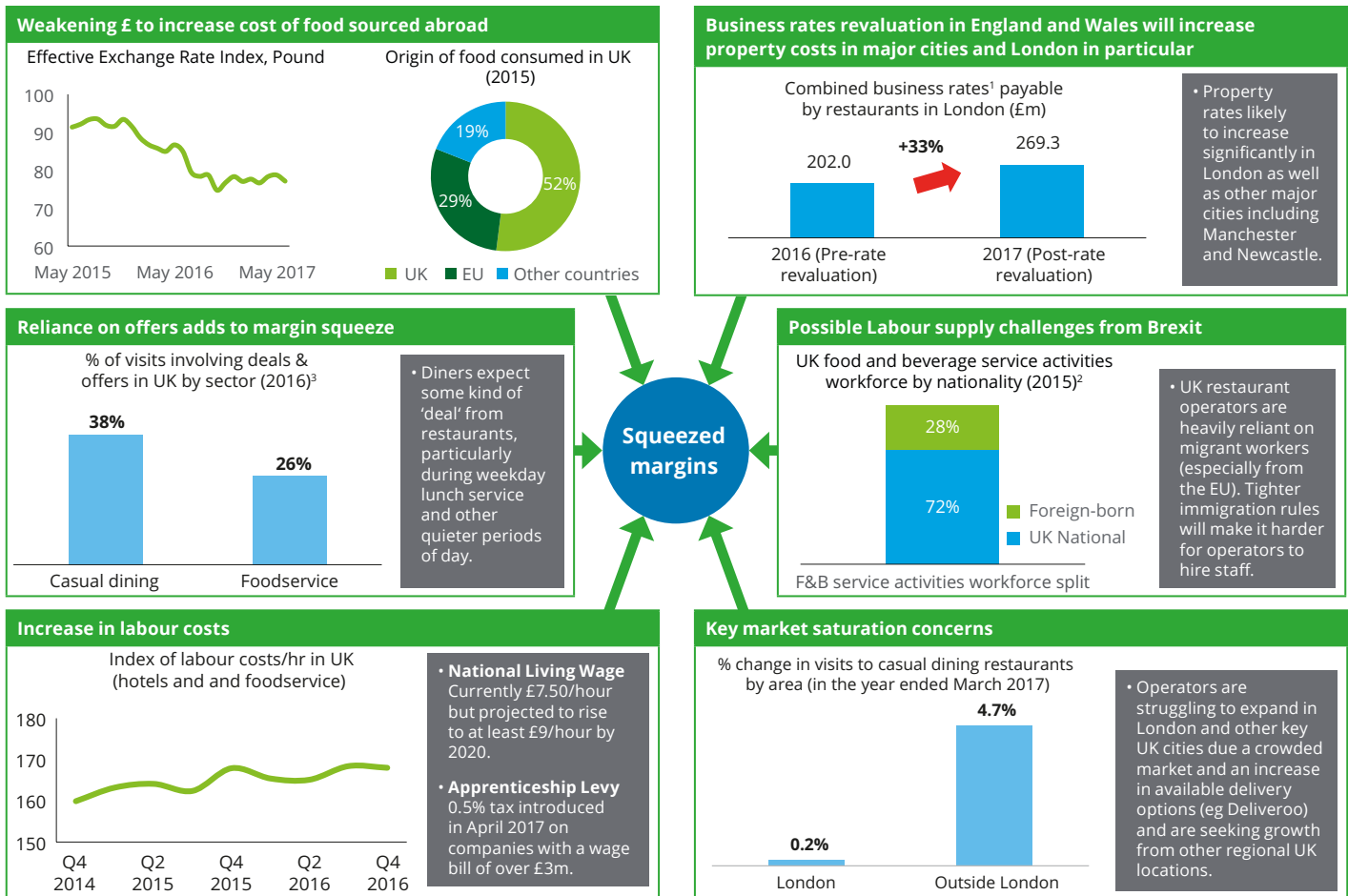
Monthly like-for-like restaurant sales

- Like for like sales growth in restaurants has been declining over the past c.18 months and is running below the rate of cost inflation (currently around c.5% p.a.)



Key trends impacting the sector

Margin pressures are mounting on casual dining operators largely as a result of rising labour costs, higher business rates and increasing food costs (exacerbated by a weaker pound following the EU referendum)



Source: ONS; NPD; Mintel; FDF; DEFRA; CVS; Telegraph; The Migration Observatory; 'UK food industry fears Brexit exodus of EU workers', FT (February 2017)

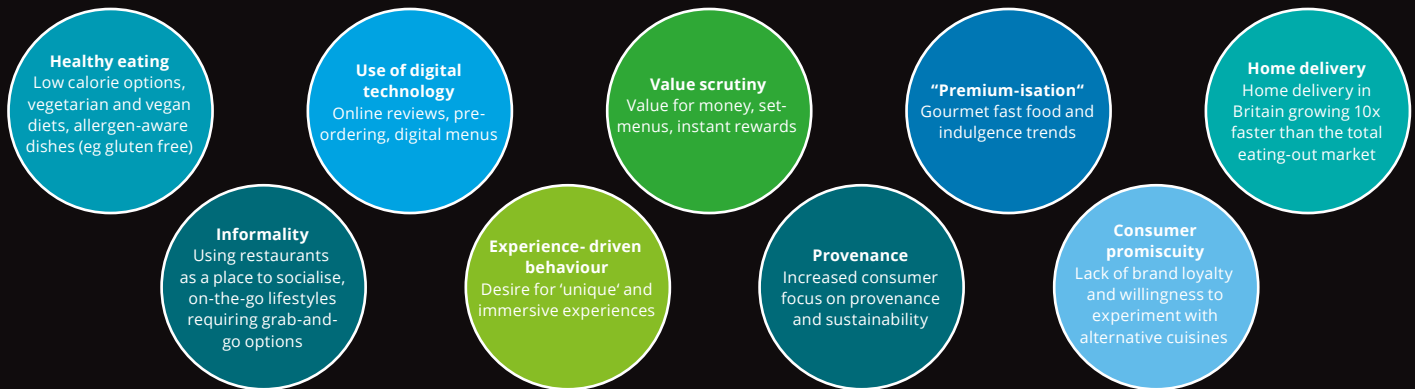
Note: 1) Combined business rates payable for 2017 is based on average combined business rate payable by 7,105 restaurants operating in London during 2017;

2) Based on 2015 Labour Force Survey published by ONS; 3). Based on a Mintel survey of 1,840 internet users, aged 16+, who eat at casual restaurants.

Key consumer trends

Casual dining operators are having to react to long-term consumer trends that are being driven by younger age groups who eat out-of-home most frequently

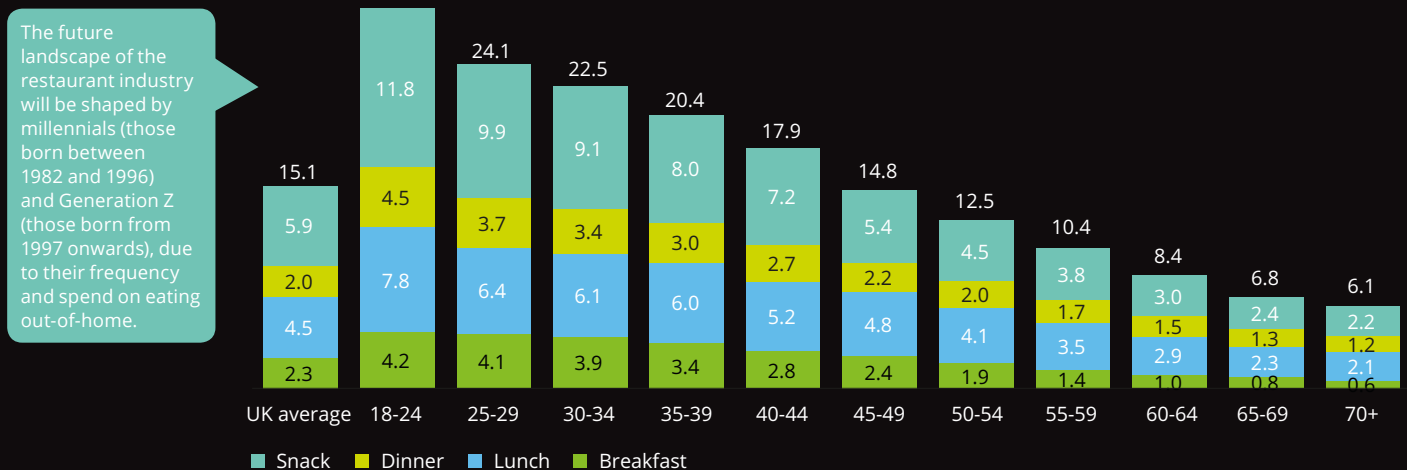
Key long-term consumer trends:



... driven by changing demographics:

UK out-of-home eating frequency by age group (2016)

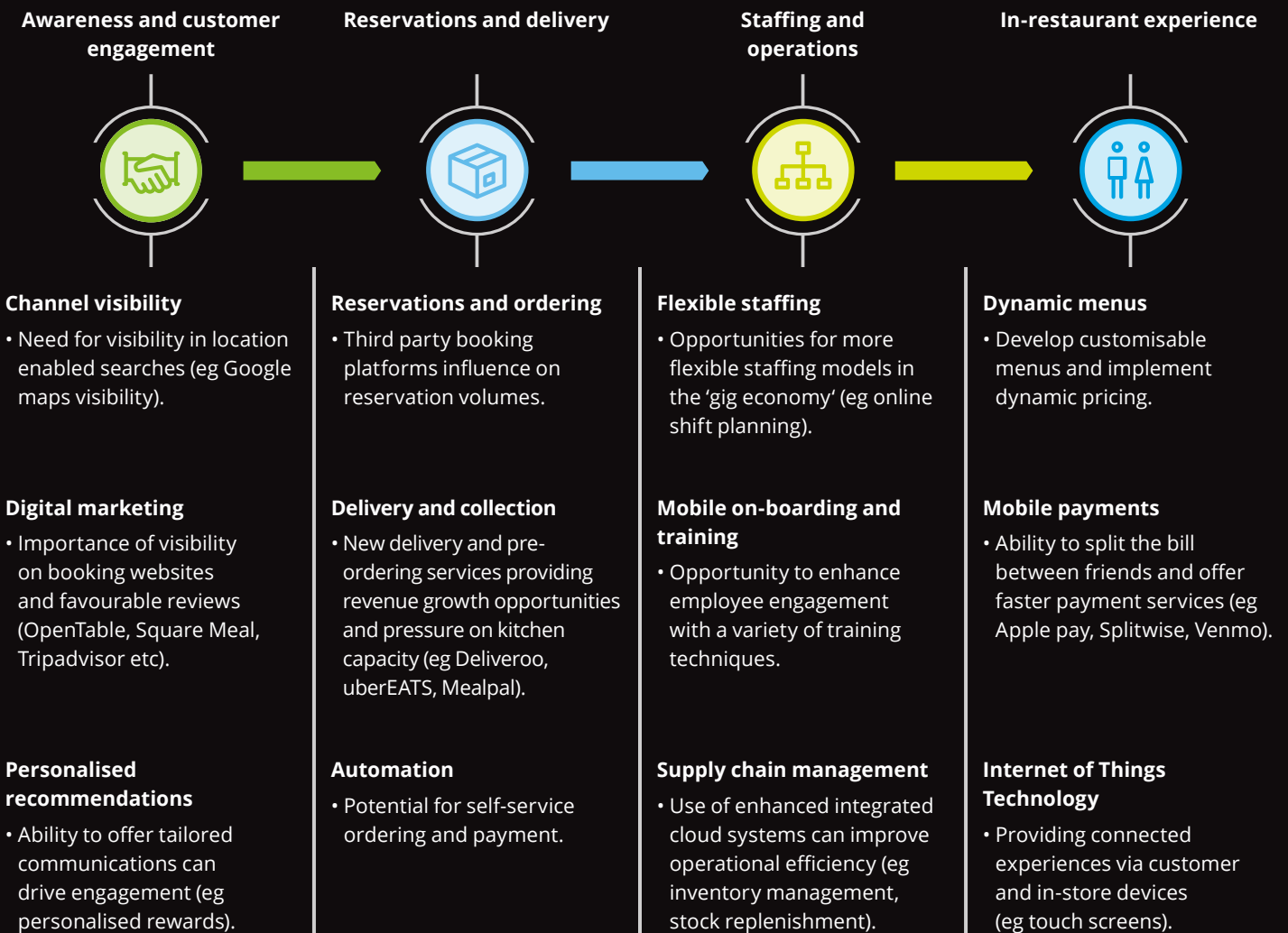
Visits per month



Source: MCA

The “restaurant of the future”

Increasing use of digital technology is providing challenges and opportunities to casual dining operators, impacting the full "customer journey" as well as business operations

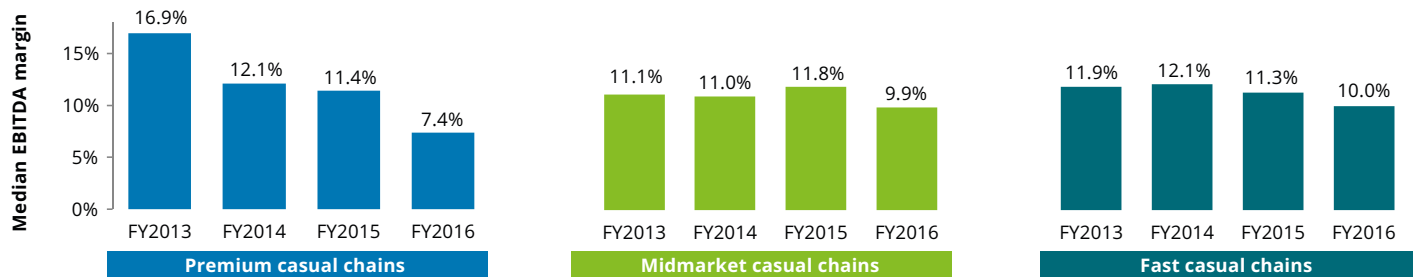
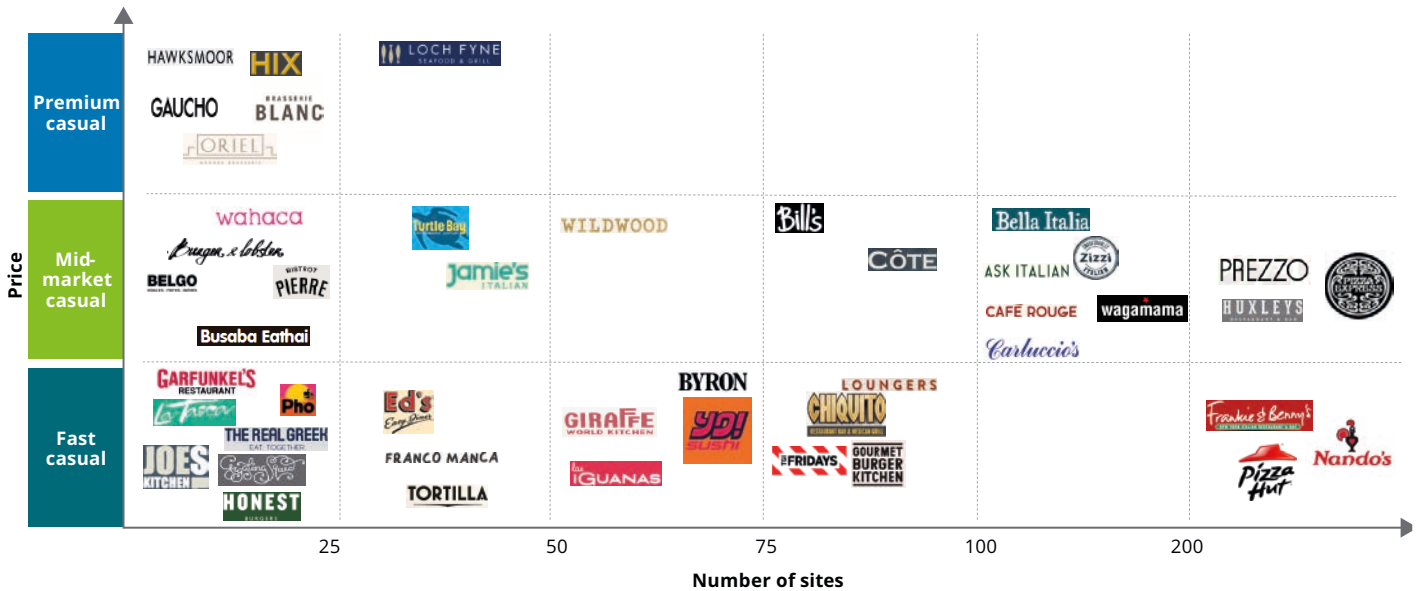


“Whilst M&A in the restaurant sector has been strong over the past few years, it appears that multiples have peaked as consumer headwinds and fears of market saturation impact the views of potential investors. However, there remains significant interest for differentiated, well-managed businesses because of their ability to drive value through roll-out.”

Ed Jenkins, Lead Director, Casual Dining M&A Advisor

Branded Casual Dining Landscape

Brands can broadly be segmented into premium, mid-market and fast, based on price proposition and service standards. EBITDA margins have fallen over recent years across all segments, with the premium sector more adversely affected than others



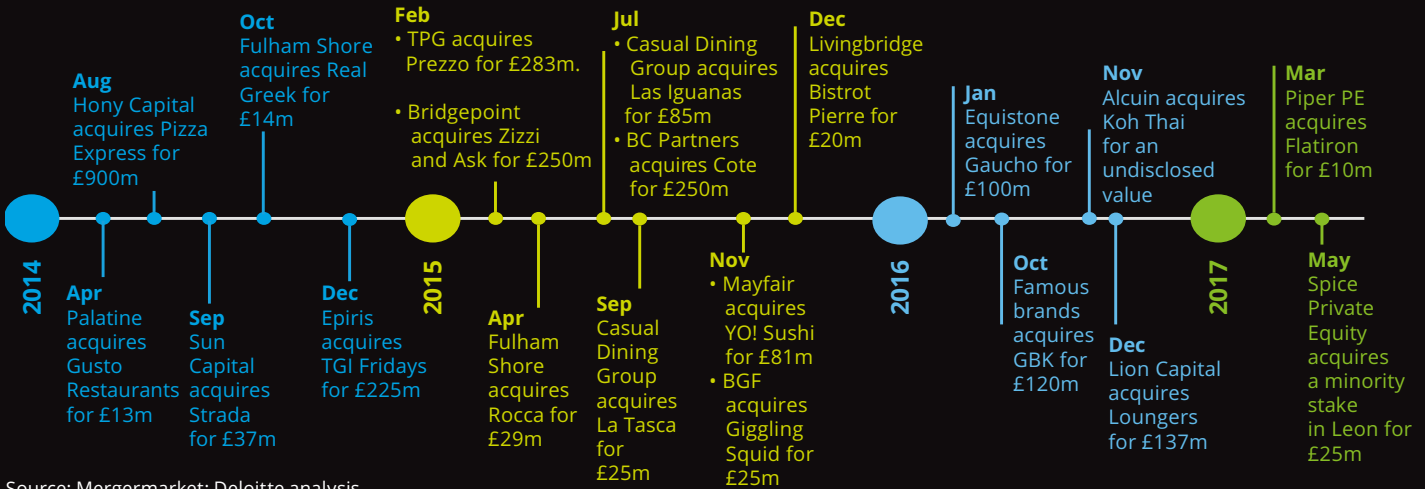
Source: Mintel; Annual Filings; Company Website; Deloitte Analysis

Note: 1) the price proposition within any of the segments is illustrative only 2) Number of sites for each brand is as of February 2017.

Overview of recent investment activity

There has been significant investment by Private Equity firms into the sector over recent years, although transaction volumes are considerably down in YTD 2017

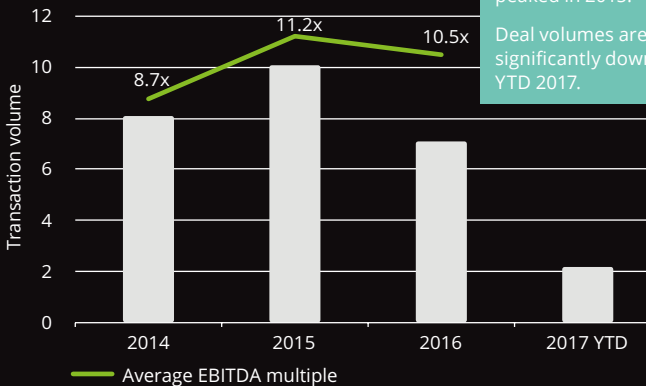
Selected recent transactions (private equity and trade)



Source: Mergermarket; Deloitte analysis

Sector transaction summary

Sector transaction summary



Transaction volumes and EBITDA multiples peaked in 2015.

Deal volumes are significantly down in YTD 2017.

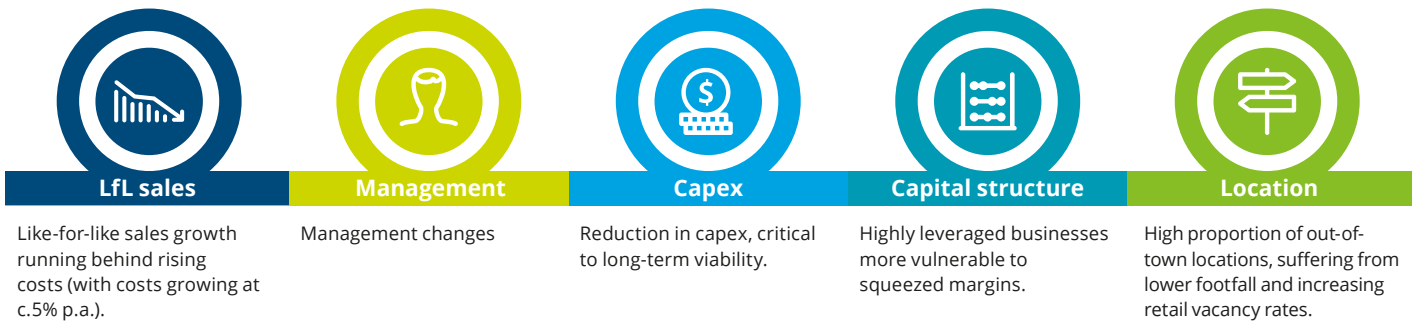
Source: Publically available information

- A surge in investments by Private Equity firms in 2014 and 2015 has helped some small casual dining chains to expand their store count rapidly (eg Cote and Giggling Squid).
- Small chains have been attractive to Private Equity firms due to their scalability, potential to professionalise management and relatively liquid market to facilitate an exit.
- Transaction multiples in the sector peaked at around 11x EBITDA in 2015, although have since retreated. Transaction volumes have also dropped off significantly in recent months as concerns regarding the impact of Brexit and consumers' reduced spending power have increased.
- Leverage in the sector is generally around 3.5x – 4.5x EBITDA, although can be higher in business with debt funded expansion plans.

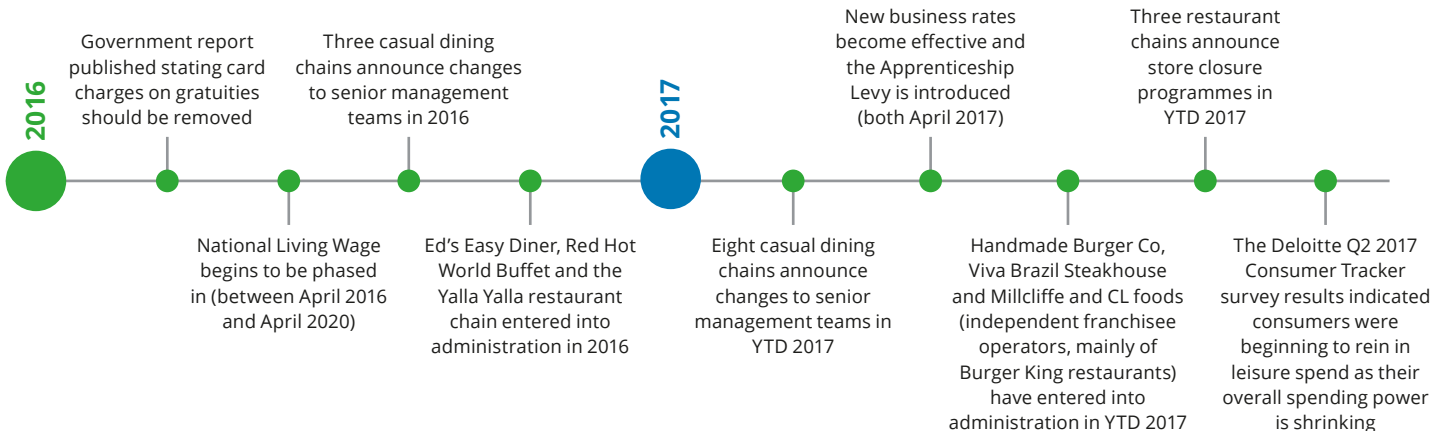
Some recent signs of stress in the sector

There are increasing signs of challenge in the casual dining industry, which has experienced an increase in store closures, management exits and losses in the past 18 months

Indicators of more challenged dining chains



...and recent news in the market



Source: Companies House; Mint; The Caterer; Propel News; Deloitte Analysis

“Casual dining operators are currently facing a real squeeze driven by declining consumer discretionary spend and rising cost pressures. In addition, there are some businesses with high levels of debt, generally as a result of recent M&A activity. This is leading some market observers to speculate there could be an increase in restructuring activity over the coming months.”

Rob Harding, Lead Partner,
Casual Dining Restructuring Services

“We have invested heavily in developing a suite of market leading analytical tools to help casual dining operators optimise their planning, pricing and trading decisions. These tools, together with our market leading real estate and corporate advisory teams, allows us to implement solutions for our casual dining clients, whatever challenges they face.”

Sarah Humphreys, Lead Partner, Casual Dining

How we can help

We have a suite of tools across our multi-disciplinary teams to help casual dining operators find solutions to the challenges and opportunities they face

Key challenges and opportunities for casual dining operators...

...how our expertise can help



Revenue growth

Growing the top-line by providing value-for-money dining experiences, offering delivery and collection, developing new site formats and delivering site expansion plans.



Improving margin

Improving margins through flexible staffing models, supply chain management and cost control.



Real estate

Finding the right locations for each restaurant format, optimising the number of outlets and the efficiency of home delivery fulfilment.



Digitisation

Use of technology to generate customer awareness, automate reservations, enable pre-ordering and improve in-restaurant engagement.



Transformation

Rescaling the business through investment, M&A activity, restructurings or divestment.

Our consulting and real estate tools

We have a full suite of analytical tools to provide a complete set of planning and pricing solutions.

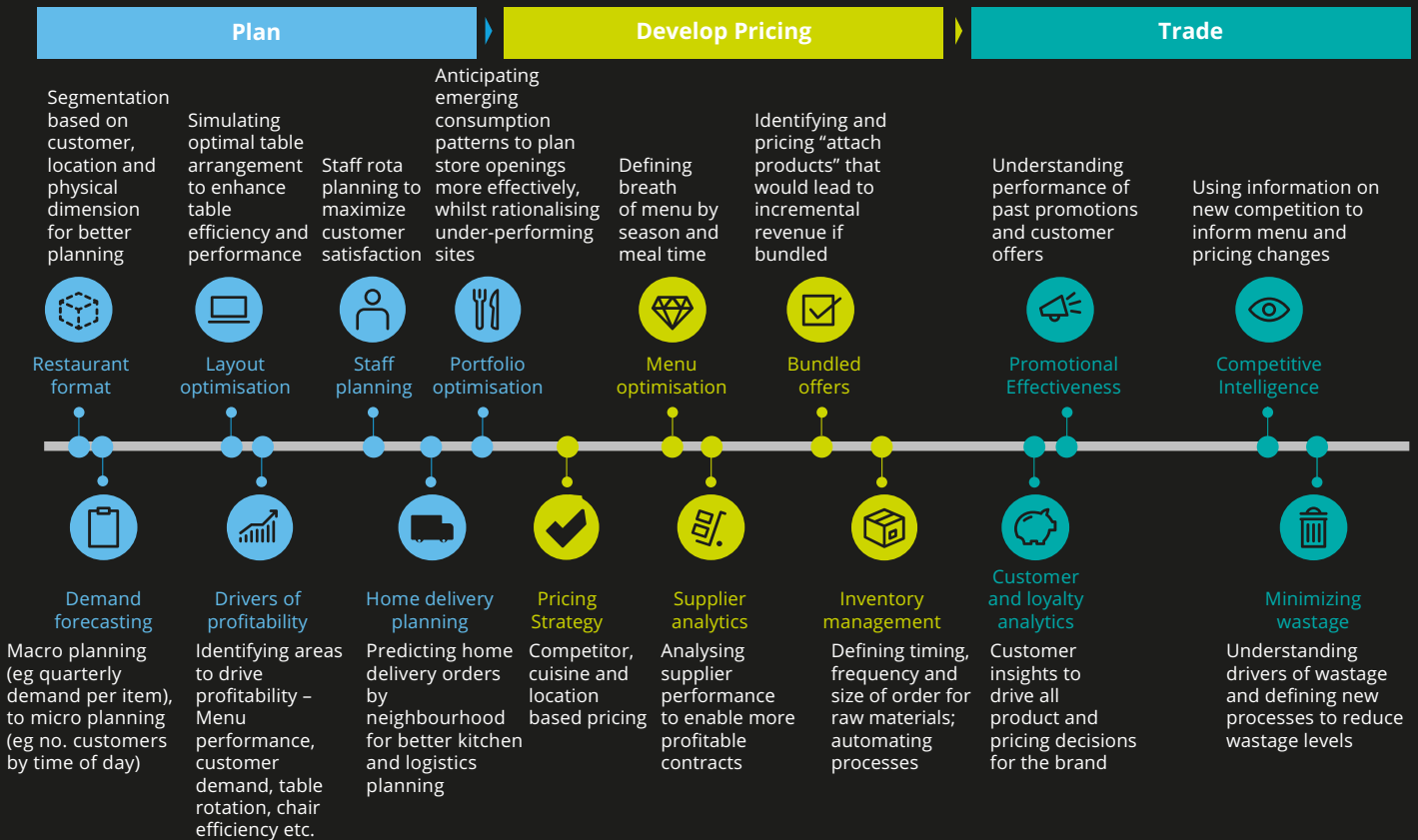
We are the only large professional services firm with an in-house Real Estate consultancy.

Our corporate finance expertise

Our corporate finance experts secure capital to drive growth and help achieve successful exits / restructurings both with performing assets and in more challenging situations.

Our consulting and real estate tools

Our portfolio of tools address the complete set of planning and pricing decisions for casual dining operators



Our Customer and Channel Analytics team helps analyse market capacity providing commercial due diligence to support the sale, investment and growth of casual dining business through location strategy, market capacity, consumer segmentation and sales forecasting for various Casual Dining businesses.

Case study – “Supported Enterprise Inns by developing a comprehensive brand portfolio and network assessment tool, deployed to all 200 regional managers to drive the group's overall format and food and beverage strategy.”

Our corporate finance expertise

Our corporate finance teams have substantial experience of working in the sector and are well placed to maximise value in casual dining situations

Examples



Securing capital to drive growth

Our M&A and Debt Advisory teams work with both high performing and stressed businesses to assist in planning, identifying and securing additional capital to fund growth plans and major investments.

Advised Gusto on MBO backed by Palatine PE; and assisted a large listed restaurant group raise a £140m refinancing package.



Due Diligence

We provide due diligence services, including financial, tax, commercial and real estate to both private equity investors and casual dining business on potential acquisitions and disposals and securing new financing.

We provided financial, tax and real estate DD services to Equistone on their acquisition of Gaucho; and financial and tax DD services to TPG on their acquisition of Prezzo.



Achieving successful exits and restructurings in challenging conditions

Deloitte's Managed Exit, Special Situations M&A and Restructuring teams can help clients to review and evaluate the main options, being to "fix and retain", sell or wind down operations.

Implemented the Pre-packaged sale of the Chez Gerard restaurant chain.

Advised Tragus on implementing a CVA for the Bella Italia, Café Rouge and Strada chains.



Ancillary services offerings supporting our corporate finance teams

We have a tax team dedicated to casual dining and licensed retail clients, providing practical tax solutions in a number of areas, including M&A, expansion into new markets and restructurings.

We provide tax advice to a number of the high street's largest casual dining chains including Pizza Express, Prezzo, ASK/Zizzi, Gaucho and Byron.



Key contacts

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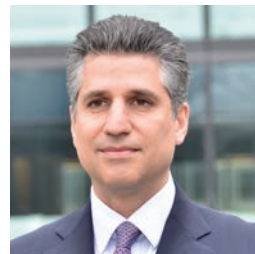
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