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Bars, restaurants and casual dining update

Spotlight on M&A in 2016

M&A activity in the hospitality sector in 2016 remained on par with the past two years, recording a steady 74 transactions.*

Whilst it would appear on first consideration that Brexit did not pour cold water on M&A in the sector, its effect was in fact more subtle – there were a number of exits pencilled in for the second half of 2016 which were put on ice.

Whilst the number of transactions has remained consistent in recent years, a gulf has emerged in total disclosed deal value. 2014 recorded total disclosed deal value of £3.5 billion, bolstered by the Pizza Express / Hony Capital (£900 million) and Spirit Pub Company / Greene King (£774 million) transactions. 2015 total deal value dropped to just over £1 billion, and rose again in 2016 to £2.7 billion, however this was inflated by Heineken's approach to Punch Taverns, valued at £1.8 billion. Removing these three big ticket deals from the analysis shows that 2014 was a particularly strong year for M&A, still with total disclosed deal value of £2.2 billion, falling to £943 million in 2015 and £900 million in 2016.

19 transactions in 2016 (25% of the total) involved a private equity investor, either as a stand-alone investment or bolt-on acquisition to an existing portfolio company – consistent with activity levels in the previous year. January 2016 saw Argentinian steak chain Gaucho Grill change hands once more, with previous investor Equistone reinvesting in a £100 million transaction, with the subsequent syndication of a minority stake to industry investor Luke Johnson. The year closed with Piper Private Equity exiting its investment in 'third space' concept Loungers, in a much-contested auction – with Lion Capital acquiring a majority stake valuing the company at £137 million. Elsewhere, Business Growth Fund (BGF) invested £3 million in Glasgow-based Asian restaurant chain Bar Soba, Kings Park Capital took a significant stake in 7Bone, a fast casual 'better burger' restaurant concept, and Alcuin Capital Partners bolstered its hospitality portfolio by backing the management buyout of Koh Group, a Dorset-based Thai restaurant operator. We envisage in 2017 that private equity will continue to invest in smaller brands, with ambitions to scale up, as they look to find the next strong casual dining brand.

Trade consolidations picked up in 2016 too. In early 2016, Ranjit Boparan's restaurant vehicle Boparan Restaurant Holdings (BRH) added The Cinnamon Collection, which includes The Cinnamon Club, to its existing portfolio of Harry Ramsden's and Fishworks. BRH went on to acquire the 15-venue Giraffe Restaurants chain from Tesco, and most recently, acquire 33 sites from American-style restaurant group Ed's Easy Diner in a pre-pack administration. 75-strong chain Gourmet Burger Kitchen (GBK) was acquired by South African-based Famous Brands, owner of the Wimpy burger chain, for £120 million; and Lebanese restaurant chain Comptoir Group acquired three Yalla Yalla-branded restaurants out of administration.

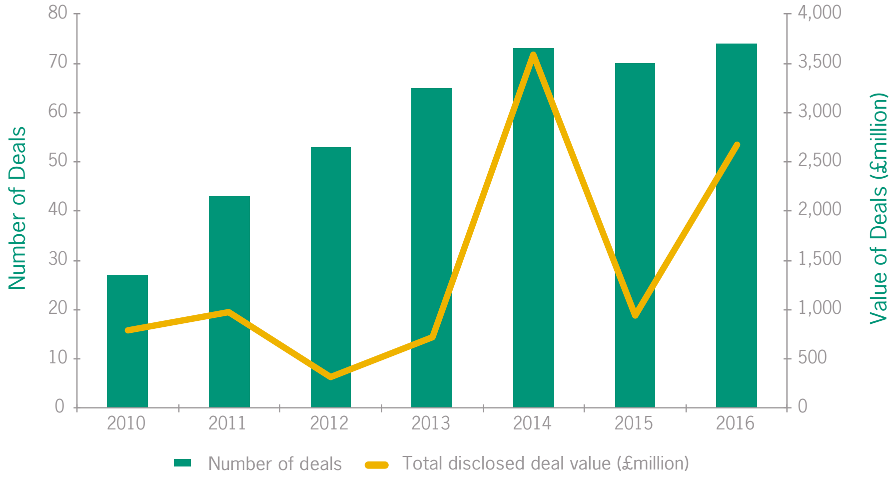
2016 generated a number of transactions in the bars and pubs sector, with the standout deal being the battle for Punch Taverns, with the leased pub operator currently having agreed to a takeover by Dutch brewer Heineken, which would see the 3,350 Punch estate split with Patron Capital, a real estate investment fund, with Heineken taking the lion's share of 1,900 pubs. The 180p a share cash offer gives the highly indebted Punch an enterprise value of £1.77 billion, 10 times its full-year earnings before interest, tax and depreciation. Assuming the deal goes ahead, a large proportion of the public houses within the UK will be owned by Heineken – adding to the Star Pubs & Bars estate it acquired from Royal Bank of Scotland in 2008.

Whilst the bars and pubs sector is highly susceptible to economic uncertainty and pressures on operational costs, confidence in the sector remains, and 2016 saw both trade and private equity review their estates triggering a raft of transactions from bars, to food-led pubs and pubs with accommodation. Q4 2016 saw Stonegate Pub Company (operator of Slug & Lettuce and Yates) acquire Intertain, owner of Australian bar brand Walkabout; the £40 million deal provided a timely exit for Better Capital. Other transactions in the year included London-based bar and restaurant group Drake & Morgan's acquisition of Corney & Barrow's wine bar business, supported by Bowmark Capital; and Graphite Capital's acquisition of New World Trading Company, a pub and restaurant business headquartered in Cheshire, in a £50 million transaction – generating a 6x return for LDC. Penta Capital also took a majority stake in the North West-based gastropub business Seafood Pub Company.

The ongoing popularity of the coffee sector was reflected in ten transactions in 2016. Tesco acquired the outstanding stake in Harris & Hoole, allowing it to then fully exit the sector with its sale of the 43 Harris & Hoole sites to Caffè Nero. In more leftfield transactions, Scottish brewer BrewDog purchased a 33% stake in

*UK / Irish target and / or acquirer.

Announced M&A activity in pubs and restaurants – quarterly



Edinburgh-based Third Wave Coffee, in order to offer Third Wave's coffee in its 29 UK bars, and DOCASA Inc., a US-listed group targeting the UK's specialty coffee market, acquired specialty coffee shop and online retail business Department of Coffee and Social Affairs Ltd, now with eleven UK sites.

The trend for healthy and clean eating continues to develop and become more sophisticated. Whitbread diversified its portfolio by acquiring a 49% stake in healthy food-to-go chain Pure for £6.8 million, with eight existing sites in London, addressing the growing demand for natural, healthy takeaway food and drink. LDC invested over £8 million in the management buyout of Vital Ingredient, also a healthy food-to-go retailer, to support the roll-out of the group both within London and throughout the UK. On a smaller scale, in February 2016, Encore Capital, alongside other sector investors, acquired a majority shareholding in Detox Kitchen, a healthy eating business providing a meal delivery service as well as operating two London delis and supplying products through select retailers.

'The only certainty is uncertainty…'

As we gain more clarity on the Brexit process and its likely implications as we progress through 2017, the only certainty is of ongoing certainty, and it is widely accepted that 2017 will be a more challenging environment, both as a result of Brexit fall-out and wider sector issues. For the consumer, the ongoing uncertainty will inevitably affect consumer confidence and therefore spending. In a competitive environment, operators are having to contend with devalued sterling, elevated costs, squeezed margins, new legislation and recalibrated business rates.

Strong competition for restaurant sites during 2016 meant that property prices rose by over 14%, according to property agency Christie & Co. With the business rates revaluation coming into effect on 1 April 2017, property costs continue to put operators under pressure – especially in London. However, there is a widely felt sentiment that rents could be reaching a level that cannot be sustained going forward. Whilst rates won't be going down, the effect of the rates review should halt or slow price increases, as a growth in the number of vacant properties will mean lesser competition for sites and lead to some rebalancing of the power between landlords and operators.

According to Hardens, a record 200 new restaurants opened in London in 2016 – beating the previous high of 179 in 2015. However, the number of closures reached 76, a significant year-on-year increase that could indicate a peak has been reached in the restaurant market in the capital. There is no doubt that it is an increasingly competitive market, with more 'traditional' foodservice operators under fire from emerging non-traditional segments that offer consumers food and beverage on demand, and innovative, niche offerings. Horizons also recently outlined the slowdown in entrepreneurial activity in the foodservice sector in the second half of 2016, with fewer new brands entering the market and a slower rate of expansion for existing operators. Whilst there will always be churn with sites closing, businesses going into administration and operators exiting marginal sites, the recent news of Jamie's Italian closing six restaurants indicates that established brands are not immune to changing industry pressures. 2016 saw the high profile collapse of Ed's Easy Diner, with BRH acquiring 33 sites, 26 sites closing, and BRH subsequently closing further sites within the acquired portfolio.

However, every cloud has a silver lining… whilst consumer confidence and expenditure could impact the UK leisure and eating-out market, reduced domestic activity could be slightly offset by an increase in foreign tourists due to the fall in the value of the pound, alongside an increase in 'staycations'.

The evolving pub market

The latest ALMR Christie & Co Benchmarking Report showed that the average costs of running a pub are at a seven-year high, with payroll costs accounting for almost 30% of turnover with additional costs coming in due to the forthcoming increase in the National Living Wage. The market has been further impacted by the introduction of the Pubs Code with the Market Rent Only (MRO) legislation, all against a Brexit backdrop. That aside, drink-led pubs and bars witnessed some pick-up in the latter part of 2016, and the latest Greene King Leisure Tracker recently demonstrated that Brits are favouring pubs as evening dining destinations, slightly ahead of restaurants and significantly ahead of fast food outlets. Food-led pubs continue to perform strongly and remain popular with the consumer, often offering a more pleasant environment than the high street.

There is also a growing trend for food-led pubs to add boutique-style accommodation, tapping into the growth of the 'staycation' and weekend breaks market. Existing operators in the coaching inns sector include Fuller's, Young's and Daniel Thwaites, alongside smaller operators such as Bel and the Dragon, The Coaching Inn Group and Seafood Pub Company. 2016 heralded two transactions in this area of the market – with Penta Capital providing backing to Seafood Pub Company's growth plans, currently with eight gastro-pubs located throughout Lancashire, half of which have boutique bedroom accommodation, and The Coaching Inn Group, which secured a further £10 million investment from Business Growth Fund to support a planned £50 million expansion across the UK. The Boston-headquartered business currently operates 12 coaching inns and will use the capital to increase the size of its portfolio to 25 properties by March 2019.

Pubs at the end of the day rely on beer sales – accounting for seven in every ten drinks sold in pubs. A new report by Oxford Economics, commissioned by the British Beer & Pub Association (BBPA), reveals that the beer and pub industry in Britain employs almost 900,000 people, contributing £23.1 billion to the British economy, and paying £12.6 billion in tax. The BBPA says the figures make clear the case for a further beer duty cut in the Budget on 8th March, to protect jobs and investment in this vital national industry. The BBPA argues that a further duty cut would help encourage investment, protect jobs and improve confidence in the sector, especially as Britain prepares for the economic challenges of leaving the EU, including the impact of a potential reduction in EU workers going forward.

Above and beyond this, Tim Martin, founder and Chairman of Wetherspoons, a vociferous campaigner for the sector and on other matters such as Brexit, argues that whilst lower excise duty is important, tax equality in the shape of business rates and VAT is paramount. He argues that the industry contributes to society in many ways, both as a major employer and contributor to the exchequer, but that the sector is crippled by higher business rates and VAT, compared to the levels imposed on pubs' main competitors, the supermarkets. He argues if the pub industry is to survive and thrive in the future, equality of taxes with supermarkets is vital.

'Eatertainment'

According to Local Data Company figures between 2011 and 2016, the largest growth has been in areas including lounge bars, coffee shops, juice bars and speciality restaurants. But above and beyond more traditional formats, consumers are increasingly demanding more than a meal when they eat out: seeking out-of-home entertainment alongside a food and drink offering, and unique experiences that cannot be recreated at home.

Consumers are drawn to new formats and often it is emerging operators with single, or a handful of sites, that can be more nimble and innovative in their offering.

November 2016 saw Boxpark launch its second pop-up mall constructed of shipping containers in Croydon – a follow-up to the original Shoreditch site – creating a unique shopping and dining destination, and featuring over 30 traders, such as Greek on the Street, Bao Bao, Knot, MeatLiqour, Chilango, Wing & Tings, The Cronx Brewery and The Potato Project.

Street food markets, pop-up street food outlets and pop-up bars are becoming increasingly popular, both in and out of London – with ambitions to take the models overseas.

In London, Jonathan Downey, has been a key figure in the street food market boom, establishing Street Feast in 2012 – which converts vacant sites into bustling street food markets with multiple street food and bar concepts. More recently, he has teamed up with Leon's Henry Dimbleby to create London Union, raising £2.5 million through crowdfunding to roll out the concept. In June 2015, the start-up raised £1 million from a number of high profile founder investors including Nigella Lawson, Jamie Oliver and Yotam Ottolenghi. Whilst the original site in Dalston had to close, it currently operates two Street Feast markets – Dinerama in Shoreditch and Hawker House in Canada Water. Third site Model Market in Lewisham will re-open in April 2017 and London Union has plans to open a new rooftop site in Canary Wharf later in 2017, as well as considering other locations including Manchester and overseas.

Also drawing high praise and success, street food concept Trinity Kitchen launched in 2013 based in shopping and leisure centre Trinity Leeds. Five street food vans rotate every six weeks alongside permanent outlets such as Chicago Rib Shack, Chip + Fish, Duck 'n Roll and Pho.

Other operators have taken the demand for food and drink alongside entertainment to the next level... from more traditional leisure formats such as bowling venue All Star Lanes (four sites in London, one in Manchester), to concepts such as Bounce, uniting the game of ping pong with food and drink (now with two London sites and launching in the US), and Flight Club, offering social darts, currently at one London site. 2016 also saw crazy golf / street food concept Swingers take a permanent 16,000 square foot site, near the Gherkin in London, featuring two nine-hole crazy golf courses, five cocktail bars, a gin terrace and three street food offerings.

Spotlight on Indian cuisine

In the last edition of Come Dine with Us, we looked at the boom in the popularity of Thai cuisine and restaurants. The British love affair with Indian food has a longer history – the first curry house was established in Portman Square, London, by a Muslim soldier called Dean Mahomed over 200 years ago. An influx of Bangladesh's in the 1940's arriving to help with the rebuilding of London after the Blitz, and in the 1970's following war in their homeland, led to many establishing restaurants. In more recent decades, a number of entrepreneurial Indian businessmen and chefs have created more 'up-market' offerings, such as Tamarind in Mayfair, Zaika in Kensington, Benares in Mayfair and Cinnamon Club in Westminster.

The past few years have continued to see newer entrants establish growing chains, and new twists on an established cuisine. JKS Restaurants is the award-winning London restaurant group behind Trishna, Gymkhana, Bubbledogs, Kitchen Table, Lyle's & Bao, with Hoppers the newest addition to the group, serving snacks from southern India and Sri Lanka. The Cinnamon Collection, acquired by Boparan Restaurants in 2016, has recently launched the new concept Cinnamon Bazaar, building on its existing portfolio of four restaurants. Cinnamen Bazaar is an all-day concept, serving modern Indian food in a 3,100 square foot restaurant in Covent Garden.

The first Bombay-style cafe Dishoom was opened in Covent Garden in 2010, and now has restaurants in Shoreditch, King's Cross and Kingly Street in London, opening its first unit outside London, in Edinburgh in 2016.

Newer start-ups in the capital include Indian small plates concept Kricket and Gunpowder, a home-style Indian Kitchen in Spitalfields, London. And in January 2017, high-end Indian restaurant The Baluchi is set to open its first site in the UK, opening in The Lalit London hotel in Tooley Street and including the Naanery, a naan-and-wine bar concept.

Appetite for curry and the success of concepts being rolled out is in no way restricted to London. Indian restaurant group Mughli now has two sites in Manchester and one in Birmingham. MyLahore, a British and healthy twist on Asian food, has built up five sites in Bradford, Leeds, Manchester and Birmingham. And Indian street food restaurant Mowgli established by barrister turned restaurateur and food writer Nisha Katona, has one site in Manchester and has just opened a second site in Liverpool. Mowgli's menu is built around the idea of 'chat', small plates with big flavours.

Looking forward

There is no doubt that 2017 is going to be a varied year for operators with all the uncertainty surrounding Brexit, increasing staffing and business rate costs and weaker sterling. Despite this there remains optimism amongst the uncertainty, volatility and competition.

One certainty, however, is that the sector will continue to draw a healthy level of M&A, from both trade and private equity acquirers. Whilst few assets go down the IPO route, the stock market will continue to appeal to certain operators and investors, such as Lebanese and Eastern Mediterranean restaurant group Comptoir, who floated on AIM in June 2016. Going into 2017, a number assets have processes underway: Yum! Brands Inc. has commenced a sale of the majority of its UK KFC restaurants; Grand Union, a London-based chain of eight bars, has reportedly been approached by potential buyers and investors, and Flat Iron, a four-strong London-based operator focusing on flat iron steak, has inevitably drawn the attention of private equity buyers. The year has also seen the sale of roadside restaurant chain Little Chef to private equity backed Euro Garages.

Grant Thornton is active in helping clients in the bars, restaurants and casual dining sector meet their objectives.

Our dedicated team advises on a range of services including mergers and acquisitions, private equity fund raising, refinancing and strategy planning as well as tax and audit work. Please do not hesitate to contact us to discuss how we can help your businesses achieve its strategic goals.

Will Baxter
Head of bars, restaurants and casual dining
T +44 (0)20 7865 2771
E will.l.baxter@uk.gt.com

Michelle Devine
Associate Director
T +44 (0)20 7184 4623
E michelle.devine@uk.gt.com

Alex Harris
Manager
T +44 (0)20 7865 2303
E alex.j.harris@uk.gt.com

Joanna Penny
Research manager
T +44 (0)20 7865 2594
E joanna.s.penny@uk.gt.com

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grantthornton.co.uk

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