QUARTERLY BRIEFING REPORT

Q3 July-September

Published 31 October 2022

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Introduction

I have been publishing The Quarterly Briefing Report since 2009. Over two years ago, at the start of the coronavirus lockdown, I started producing The Weekly Briefing Report to provide a more immediate view - and this remains available free of charge.

I also produce theDelivery.World - a fortnightly newsletter – and that, too, is free of charge

I would value your feedback on topics you would particularly like me to add to my coverage - my email address is peter@peterbackmanfs.com and my phone number is 07785 242809.

Headlines

In my Monthly Briefing Report of just a month ago, I commented on the momentous changes in the previous month – notably the death of the Queen, the emergence of a new Prime Minister and a budget that rocked financial market and the political scene.

I painted a picture of some growth in the foodservice sector albeit aided by a substantial uplift in inflation. This current report paints a much bleaker picture, but I would stress that the foodservice sector has come through many difficult periods over the past fifty years. It has shown itself innovative, energetic, entrepreneurial, and willing to take risks it can be managed, and it will improve. I fully expect a similar set of responses this time round.

I specifically noted in that last Monthly Briefing Report: "Because the scenery is fast moving, I have a word of caution. What I say here may well be out of date by the time you get to read what I've written; perhaps some political initiative will have changed the landscape, or some economic development may have created a change of direction."

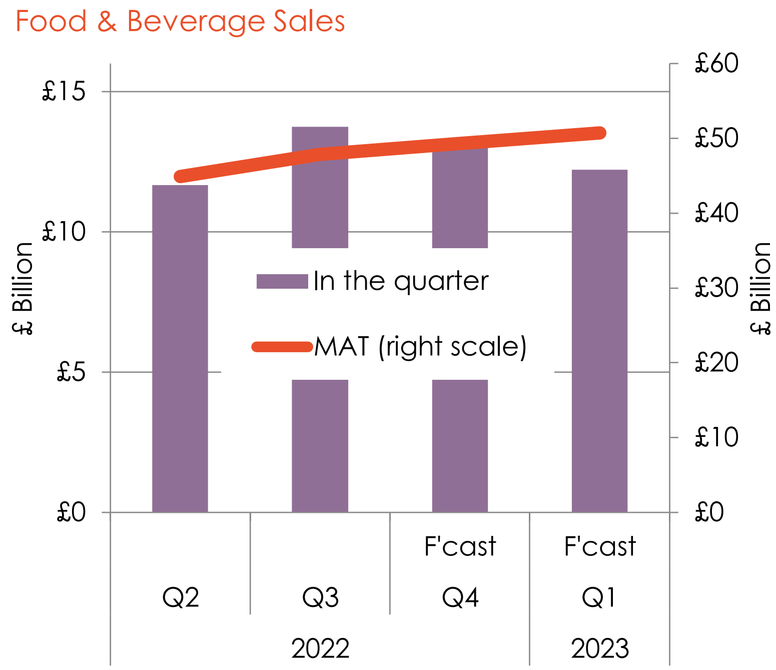
To which I can only say: You can say that again!

In the past month we have seen the emergence of yet another Prime Minister and in the past quarter we have seen: the death of the Queen, 3 Prime Ministers – the departure of two and the creation of 2 - a budget met with huge pushback from the markets and voters, a consequent reversal of much of the budget, ongoing rise in inflation, and ratcheting up of the conflict in Ukraine.

The full effects of these, and other, factors are only starting to become clear. History will show whether they are just way stations on the route we have already been travelling, whether they represent a low point from which things will start to improve, or whether, they represent a significant change for the worse.

I don't want to get sucked into making comments about political, monetary, or fiscal issues. I just want to comment on the foodservice sector. And my analysis, in short, is that early next year will be a time of great danger for the sector.

In saying that, I recognise the complications. Some of the factors that I shall discuss affect both consumers and operators, other factors only (or mainly) affect just one or the other. Then there are feedback loops – inflation removes money from consumers' pockets, so they have less money to spend on eating out, operators suffer from this loss and feel the need to stabilise their prices but inflation also hits their costs and so they are forced to raise their prices, thus making them even more economic for cash-strapped consumers, and so it goes on.



Source: Peter Backman

Note that, as normal, in my Quarterly Briefing Report I am providing forecasts over the next two quarters – Q4 2022 and Q1 2023 ie October 2022 to March 2023. In that context, in this report I refer to this period as the 'forecast period' (or 'the next two quarters' or 'the next six months'). I also sometimes comment on periods beyond that, in which case I try to make the period obvious.

In trying to make sense of the past quarter, I think it's helpful to take a further step back in time to the situation just prior to covid.

Pre-covid

The country had voted for Brexit in 2016.

In the 2018 to 2019 period, the foodservice sector was starting to show signs of shakiness, eating out was not growing at its former pace – perhaps because consumers did not have the same desire to eat out or spend as much on eating out as they had done.

A factor contributing to this was overcapacity, especially in the casual dining sector and in emerging food-to-go markets.

Quality – of product and service - was, arguably, also declining because operators were becoming complacent in their dash for growth.

Expansion had become too easy on the back of low costs of finance. Overcapacity, in the form of too many outlets in shopping centres, leisure sites, transport hubs and high streets, was being felt in the form of reduced sales in each outlet. The number of outlets was growing faster than the consumer was spending on eating out, consequently the 'average' outlet was seeing its sales fall. But because the number of 'average' outlets was small, the overall effect of reduced sales per outlet was felt in some stores but not others – some saw growth while others didn't.

At the same time, consumer preferences were developing – and noteworthy was the growth in coffee shops, in plant-based food, and in 'experiential' dining.

Overlaying this scene there were severe pressures on property prices with growing tensions between landlords and business tenants.

That was the situation in early 2020

Covid

It is incorrect to assume that covid is now in the past – the medical fraternity warn us that it can return (and probably will) but hopefully not with the severity of its first entrance.

But for now, in autumn 2022, the UK population has come to terms with covid, albeit with some wariness and some precautions. In a general sense, then, there has been a return to pre-pandemic practices – with continuing effects on some attitudes and practices including the continued wearing of wearing face masks by some people, and the continuing practice of working from home.

In its early stages, covid meant that the commercial foodservice sector had to find new sources of income and as a result developed, or rapidly increased, delivery, click and collect takeaway, and services for the vulnerable.

On the other hand, the non-commercial sector, especially the health sector, continued to serve food during the whole of the pandemic.

Feeding at work, which straddles the commercial and non-commercial sectors, suffered a severe downturn during covid and has not yet returned (if it ever will) to pre-covid levels because of changing work patterns.

All of these changes were possible with the benefit of financial and other support measures from central government – furlough, CBILS, tax holidays, the Eat Out to Help Out scheme, and the like – plus other measures such as restrictions on the ability of landlords to evict business and private tenants

Pressures such as these were evident from early 2020 and into the first half of 2022

Partly because of Brexit, legally achieved on 1 January 2022, and partly arising from the re-configuration of national and international supply chains disrupted by covid, pressure was building up internationally and more locally – food shortages and difficulties in finding staff were becoming major issues.

And then Russia invaded Ukraine. This exacerbated existing supply chain issues and introduced an additional note of uncertainty amongst consumers, businesses, and governments.

And so, we arrive at the last quarter. But before summarising the recent past, here is a quick overview of what concerned us a year ago.

What happened this time last year?

- VAT in hospitality was increased from 5% to 12.5%
- The furlough scheme ended
- 'Pingdemics' ceased to be a significant issue

- There were labour shortages and supply chain issues
- There were concerns about incipient inflation
- There was much talk about low numbers of overseas visitors
- Working from Home was an issue of growing comment (and concern for some)
- But there were growing signs of growth

How foodservice did in the last quarter

The best that can be said about the last, summer quarter for the whole sector is that it could have been worse.

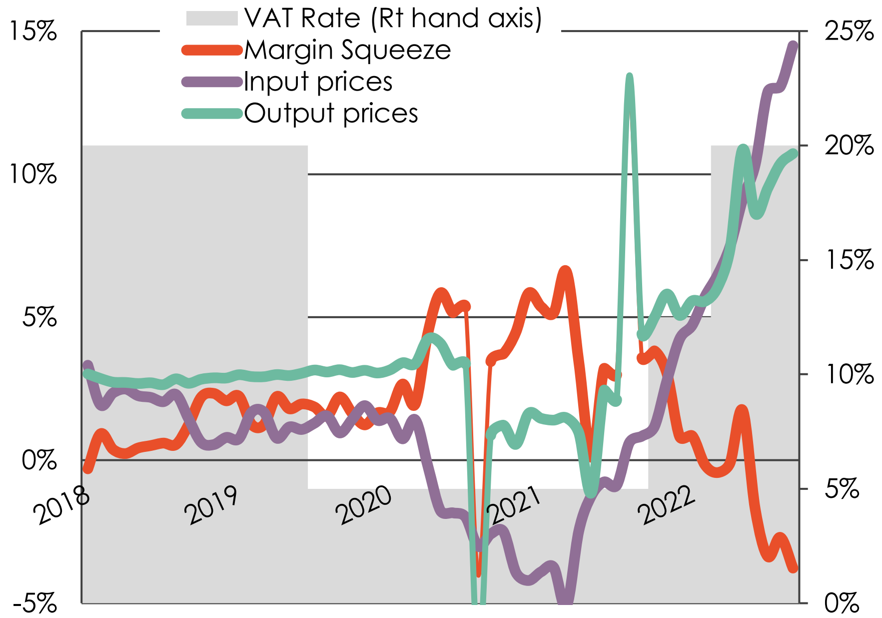
Operators were, as they still are, concerned by looming price rises and potentially falling demand.

It might, therefore, be helpful to examine the issues that confronted the sector in the quarter – most of which will remain in the forecast period.

Inflation

Inflation is increasing globally – in the western nations it is currently approaching 10%. In the UK it is already there and is highly likely to rise further over the coming months.

Margin Squeeze



Source: ONS; Peter Backman

And in the foodservice sector, key input costs are rising even faster – food and beverage prices are rising at close to 20%, electricity and gas prices are rising by 350%.

Although all operators are seeing the cost of their supplies increasing – for some well, in excess of the headline rate - and for others, below it. So, the product mix of any single operator will determine the overall inflationary increase it experiences.

For some operators, the increases will be unsustainable, and in extremis it will mean the closure of their business. For others, notably those with adequate cash reserves or access to further finance, it will mean an awkward period until inflation is once again at lower levels.

Overall, rising inflation will have a significant impact on the foodservice sector in terms of the pressing need to increase prices, and the reality of cost pressures that lead to depleted financial reserves – this is happening now and will certainly continue over the next two quarters. The current impact is highlighted by the current direction of the Margin Squeeze – downwards - to levels not seen sine the Great Recession in 2009 / 2010.

But the impact is not going to be felt only by operators; consumers, too, face rising costs for their everyday purchases and anything else they buy, from beer to burgers, and from holidays to hairdressing. This, in turn, will 'steal' money from their pockets making it difficult to justify their former eating practices – they will spend less on eating out.

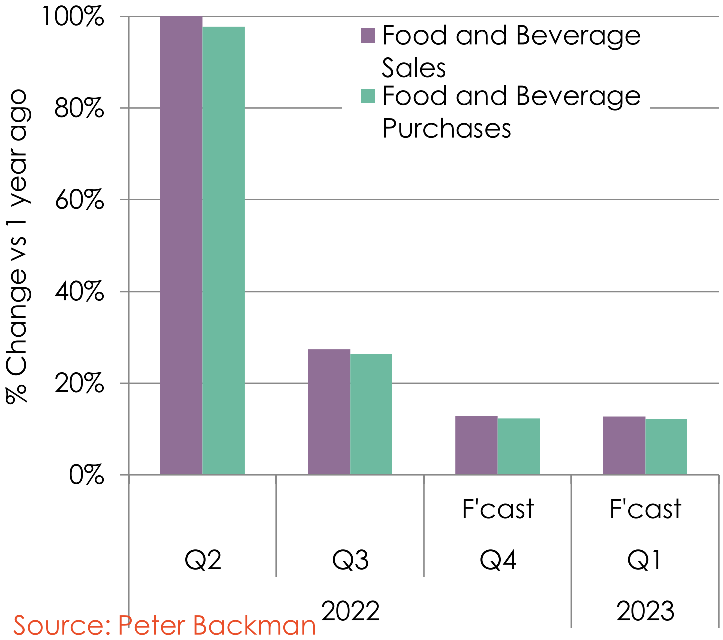
Given recent experience, this is likely to mean eating out less frequently but spending more when they do – and with a search for 'better value' when they eat out.

While there will be this search for 'value for my £', it does not mean the end of eating at cheaper places. Indeed there is much talk about increased spending at both ends of the spectrum but less in the sectors between them – the middle will get squeezed. While I am keeping an open mind on this, I feel it is probably correct.

Fuel costs

A particular component of the inflationary impetus is the rise in fuel costs resulting, to a large degree, from the effects of the war in Ukraine.

Nominal Change in Food & Beverage Purchases and Sales



Source: Peter Backman

In a nutshell, fuel costs are rising by a factor of 3 or more

The government will shield consumers from some of this rise by undertaking to pay the cost of their energy above a specified level – but only for the next six months. Each household will find the overall cost of the energy it uses, rises by a different amount. But the average figure has been set at £3,549 from 1 October – a doubling of the previous average.

While this increase is less than it would be without government interventions it is still a very significant, perhaps unaffordable, amount for many. And the situation beyond next April is unknown. The government will no doubt be hoping that energy prices will be falling at that time so that the cost of its support will also fall. But if it doesn't …

The government intends to limit energy price rises for businesses, generally, to the same levels seen by households also for 6 months at which point the scheme will be reviewed. The previous Prime Minister was on record saying that sectors 'like pubs' (and therefore the wider hospitality market?) will be supported further at that time, if necessary.

But the current uncertainty over support beyond next spring is cause for serious concern amongst operators.

Some businesses have hedged the costs of their energy supply – some have been able to do this for a year or more, but others will have to renegotiate their prices in the coming months when they might still be exposed to the current high level of energy costs.

Depending on how the war in Ukraine develops, and how soon significant alternative supplies can be sourced by importing nations, this period of high energy costs might be short, but it might extend for a long time

Prudent business will no doubt assume that it will be the latter.

The results for the foodservice sector will include: reduced consumer expenditure – ie lower foodservice sales; and a large increase in fuel costs – enough to tip some (probably many) operators into a position where they can no longer trade.

In short, over the next six months, the outcome of higher fuel costs will be serious – less trading and more business failures – and that will continue so long as energy prices remain at their elevated levels.

War in Ukraine

I mention the impact of the war in Ukraine in several contexts. And here I can provide a summary.

One impact is on the mood of government, businesses, and consumers. This leads through to confidence – or lack of it – and this further feeds through to an unwillingness to spend and invest. Foodservice businesses and consumers alike will be affected in this way.

I am unable to quantify the impact of this change in confidence over the forecast period and beyond except to conclude that it will be negative for all concerned

The way that the war is being conducted, and the politics behind it, is leading to inflation – and its impact especially on the cost of energy, some foodstuffs, and fertiliser.

Overall, the war has significantly contributed to higher prices in the short term, and almost certainly for the longer term too. And related to that, it will also lead to reduced availability of some products – with knock-on effects arising from unbalanced, disrupted global demand for many of the products concerned.

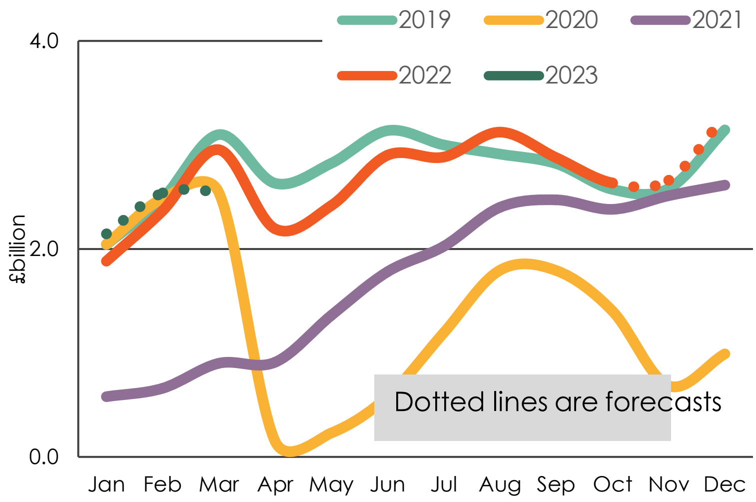
As I comment elsewhere in this report, there will be more inflation and less choice over the forecast period.

Borrowing costs

The cost of borrowing is increasing – partly because of global issues and partly because of the fall in the value of sterling.

And the impact is going to be felt by consumers whose mortgages will increase, in many cases dramatically (but for others with long term mortgages the impact may not arrive if interest rates fall before the contract needs to be renewed).

F&B sales - Restaurants, QSR, Pubs



Source: Peter Backman

The increases will also make home-owning impossible (at least in the short term) for some, leading to considerable levels of dissatisfaction, and loss of confidence, amongst consumers.

Thus the overall result of large, and rapid, increases in borrowing costs are a hit to confidence (and therefore to eating out), less money for consumers to spend, and a hit to corporate balance sheets in foodservice (and elsewhere). These impacts will manifest themselves during the forecast period and no doubt beyond that.

Workers' visas

The Government has recognised the shortage of workers – occasioned by a confluence of factors notably Brexit and covid. And the plan is to relax existing restrictions on certain classes of workers.

It seems that the type of overseas workers formerly employed by the foodservice sector – managers, waiting staff, kitchen staff – will not be favoured. But those engaged in seasonal agricultural work will be.

Thus, the impact on foodservice is not particularly beneficial apart from making supplies of seasonal products grown in the UK less insecure.

The shortage of staff suitable for employment in foodservice will remain.

The cynic would argue that, given all the other pressures this one can be managed because business will fall and therefore there will be less demand for staff.

Over the next two quarters I can see no change to availability of foodservice staff – so the existing effects (closing on some days, or for some day parts, increasing wages, simplifying menus so that kitchen staff can be reduced etc) will continue.

Global Travel

Despite the negative impacts of a looming, possible international recession, or the growing significance of the war in Ukraine, travel – both within a country and between countries – is on the rise globally

This will feed into the other reasons for increases in overseas visitors to the UK and will mean potentially more visitors to the UK (although, I am not making any specific forecast either for the short term or the longer term).

Strikes

Strikes seem to have returned and while some have not had, and will not have, a measurable impact on foodservice, some others may do especially strikes amongst workers in the food supply chain - dock workers for example.

Right now, there are specific problems arising from current strikes but unlike thirty or forty years ago, they are not currently affecting the economy as a whole. Let's hope it stays that way.

Climate Change

Variable and increasingly violent weather seems to be a given now – and there is likely to be a period over the forecast period when the weather exerts a malign influence over the foodservice sector – floods, unusually cold weather, unusually warm weather, excessively high winds, all have the potential to disrupt foodservice trading, at least locally.

While I am not forecasting the weather over the next six months, it is probably prudent to assume disruptions to (some) foodservice operators through storms, floods, wind, snow, and rain.

The Budget

The budget of 23 September has largely been done away with in the intervening last few weeks.

Nevertheless, for the sake of completeness it may be helpful to provide a reminder of what it proposed. In my Weekly Briefing Report of 2 October I noted these specifics which impacted the foodservice sector:

> "All except the highest earners, will have less to spend. Any reductions in their tax bills will, for most people, be more than swallowed up by increased costs of everything - from their food to their mortgage interest payments. And then there are the 'soft' impacts of the budget – a negative hit to confidence, mood, attitudes, and an overall increase in uncertainty.
>
> "On the other hand, the budget may provide a bit more security for foodservice businesses (and business generally). But this is unlikely to take effect until well into 2023 if at all. Another very slight bright spot is the possibility of some increase in overseas visitor numbers encouraged by easing of VAT. Any benefit from this will be felt in London (and other tourist locations) where demand may also be bolstered, to a small degree, by some increased spending by the highest earners.
>
> "Overall, the effect of the budget specifically on foodservice is likely to be less consumer expenditure in all, but a small selection of some higher spend, outlets. At best, it's going to be a case of a smaller reduction in sales than otherwise would have been the case. But it seems to me that ultimately an unknown, but probably significant, number of loss-making and marginally profitable businesses across the foodservice sector will still fail as a result of the budget".

What remains now?

In summary:

Some proposals of the budget of 23 September remain:

- National Insurance will now stay at its former level (rather than increasing by 1.25%).
  - My view is that this will have marginal / no impact on the foodservice sector as far as the majority of consumers are concerned. Higher paid people, may spend more in restaurants but the overall impact will be small
- Lowered levels of Stamp Duty to remain.
  - This, too, will have marginal / no impact on the foodservice sector, although any positive impact is much more likely to be from increased expenditure by the better off
- The cap on banker's bonuses will remain.
  - This will also have a small favourable impact on spending in higher end restaurants

Some proposals have been cancelled:

- The headline rate of Income tax will not now be reduced by 1%.
  - This might have led to a small increase in foodservice sales
- The top rate of income tax will remain at 45%.
  - Any benefits from the proposed reduction in the form of increased spending in restaurants by the higher paid, which I had anyway assessed as being small, will now not be realised
- Reduction in Corporation Tax (from 25% to 19%) will not now be implemented.
  - The benefits to corporate balance sheets will not now be felt
- Alcohol duty will not now be frozen until January 2024 (as planned).
  - This means that the possibility of limiting price rises in pubs (and hotels and restaurants) is reduced
- The proposal to remove sales tax for overseas shoppers was scrapped
  - This will probably have minimal effect on the amount that overseas visitors would spend in restaurants.

In addition:

- The energy price cap for consumers (and the separate one for businesses) is to be set until April 2023. Thereafter, the government will decide what policies / action to put in its place.
  - Depending on what happens next April, there may be a potentially further significant reduction in consumer expenditure.

The net result of the changes to the original budget, as far as the foodservice sector is concerned, is very limited in terms of sales over the forecast period. And, over the longer term, foodservice businesses will be further weakened.

But that is not the end of it because there will be another budget later this month. It is widely expected that it will lead to increased taxes, and these will inevitably take even more money out of people's pockets further reducing their ability to spend on eating out (amongst many other things, of course) over the long term.

However it should be remembered that these fiscal changes will not come into effect in the next two quarters, indeed some will not take effect until 2024.

Nevertheless, whatever the outcomes of the subsequent reversal of the budget, the situation overall for the foodservice sector remains very rocky over the coming few months.

And finally, some (possibly) better news

I can forecast with some confidence that **Christmas** will arrive and with it some better trading for a while.

However, the amount of business is unknown – it has been well below 'normal' levels for the last two, covid years. And there is a danger that if business is 'too' low (whatever level that may be), it will have happened for three years in a row, at which point maybe the lower levels will get 'baked in' to long term trading over the Christmas and, into the future, there may be a change in the way that consumers celebrate Christmas. I hope I'm wrong

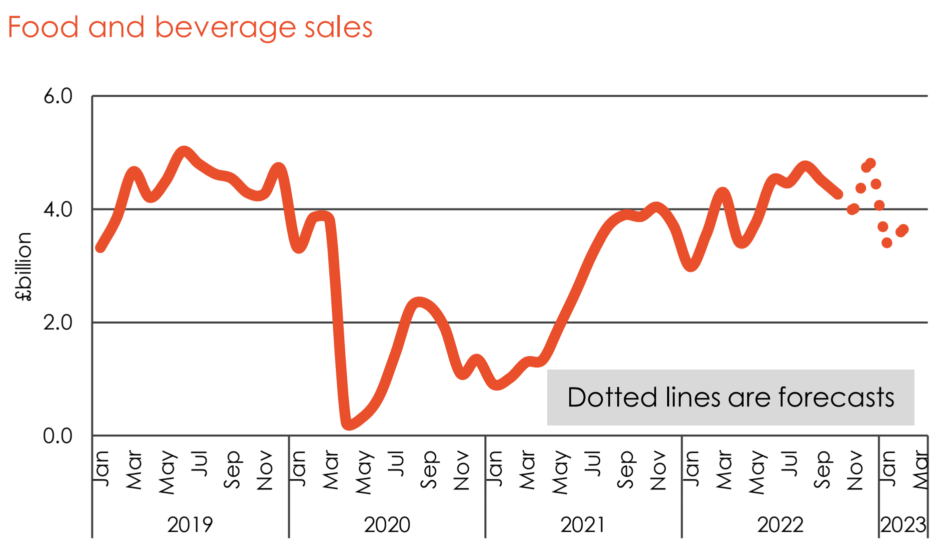
Before Christmas, there is the **World Cup** in November and December which is traditionally a good period for pubs (less so for restaurants) especially if the home team does well.

With luck, any **covid** outbreak in colder weather (when people are more likely to be indoors) will not be too serious. I hope that is the case.

My conclusions

Drawing conclusions from the litany of bad things that are happening is painful. I would put the impacts under two headings for the forecast period:

Hard impacts, such the fall in the value of the £ and interest rates, are leading to increased costs and reduced expenditure by customers, and therefor reduced sales for foodservice operators



Source: Peter Backman

The big risks surround corporate failures.

And then there are the **soft impacts** – on confidence, mood, attitudes, overall uncertainty. These are likely to also lead to reduced expenditure as well as reduced investment by operators.

My **overall assessment** of what the above analysis means for foodservice is that things will not improve over the forecast period – indeed they will **probably worsen measurably** because all the risks are on the downside

A (very) **slight bright spot** is some increase in overseas visitor numbers in the short term; their expenditure in London (and other tourist locations) will be bolstered to a very small degree by increased spending by high earners.

The last quarter in numbers – and forecasts for the next two quarters

In this section I give my view of the headline numbers for the entire foodservice market and its supply chain in the last two quarters – and the next two.

In brief:

1. Total food and beverage sales in the last quarter were £13.7 Billion – and stood at £48 Billion over the previous twelve months

2. Food and beverage purchases by operators grew by a quarter over the past year – with about half of the increasing coming from inflation. Real sales grew at perhaps 10% compared with covid-impacted 2021

In reading these forecasts it is also important to recognise that it only looks at the current situation. The full impact of the ramping up of the war in Ukraine (or at least the rhetoric surrounding it) and the social, political, and financial aftermath of the budget of 23 September will be felt over the longer term.

Quarterly Trends		2022 Q2	Q3	Q4 F'cast	2023 Q1 F'cast
Food and Beverage Sales					
In the quarter	£ Billion	11.7	13.7	13.1	12.2
MAT (right scale)	£ Billion	44.9	47.9	49.3	50.7
% change vs 1 year ago		101%	27%	13%	13%
Food and Beverage Purchases					
In the quarter	£ Billion	4.3	4.8	4.8	4.5
MAT	£ Billion	16.4	17.4	17.9	18.4
% change vs 1 year ago		98%	26%	12%	12%
Food purchases					
In the quarter	£ Billion	3.1	3.0	2.9	2.7
MAT	£ Billion	10.6	11.2	11.5	11.8
% change vs 1 year ago		78%	23%	13%	9%

Source: Peter Backman

Summary

- The next two quarters for the foodservice sector will, at best, be unsettled – and will likely be dire for the foodservice sector as a whole
- A real danger period will be Q1 2023 after Christmas trading results are in. The actual level of Christmas trading is, of course, still unknown but I assume it will be OK (which is nowhere near saying it will be 'good'), because consumers may be inclined to spend what they can even knowing that hard times lie ahead
- But even now, consumers are finding their disposal income severely compromised – by inflation, especially on energy costs, and higher mortgage payments and rent
- Some consumers will be faced with especially challenging spending priorities
- Overall, consumers will be spending less especially in early 2023 although high inflation will give the pretence of an uplift in sales
- Foodservice businesses, like consumers, face large increases in energy and borrowing costs and, for many, their balance sheets are weakening
- These negative impacts – reduced sales, higher costs, and a weakened financial position – will come together early next year to create a time of great uncertainty for the foodservice sector.
- Some operators will be cushioned or will find that their sales are not significantly reduced – high end restaurants, much of the food to go market for example.
- But most operators will suffer.
- Q1 next year will be extremely difficult for the foodservice sector

As always, I produce short term – monthly - data for each market sector, distribution channel, temperature etc. Contact me if you want to access relevant data for your business – to benchmark your existing performance, or to help you assess what your future prospects look like.

Industry news

In my Weekly Briefing Report, I include relevant industry news that relates to recent periods including the current week. Below I have listed the news items that cover a longer time period:

Note: Comparisons are with the prior period unless stated otherwise.

Restaurants

- San Carlo Restaurant Group sales fell -25.1% in the year to end September 2021
- Malhotra Group sales rose 33.7% in the year to end March 2022
- Burger & Lobster sales rose 40% in calendar 2021
- PizzaExpress sales rose 35.7% in calendar 2021
- Burger & Lobster sales rose 40% in calendar 2021
- Rosa's Thai sales rose 66.8% in the twelve months to end March 2022
- Richard Corrigan Restaurants sales rose 228% in calendar 2021

QSR

- Sim Trava sales rose 60.5% in calendar 2021
- Lemaca sales rose 52.5% in calendar 2021
- Five Guys UK sales rose 44.5% in calendar 2021
- Jollibee UK sales rose 186.5% in calendar 2021
- Lambtrad, sales grew 47.3% in calendar 2021
- QSR Colicci sales rose 65.7% in calendar 2021
- Itsu sales rose 51% in calendar 2021
- Scoffs Group sales rose 49.6% in calendar 2021
- Bansols Beta sales rose 21.4% in calendar 2021
- Capital Arches sales rose 46.3% in calendar 2021
- White Rose UK sales rose 52.9% in calendar 2021
- Boston Tea Party sales fell -8.9% in the year to end October 2021
- Lola's Cupcakes sales rose 27.1% in calendar 2021 versus 2019

Pubs

- Chilled Pubs sales rose 37% in calendar 2021
- BrewDog bar division sales 46.5% in calendar 2021
- Knead Group sales fell -5.6% in calendar 2021
- Black Sheep Brewery sales rose 7.5% in the year to end March 2022
- Innis & Gunn sales fell -1.2% in calendar 2021
- New World Trading Company sales rose 250% in the year to end March 2022
- Amber Taverns sales rose 87.3% in the year to end January 2022
- Anglian Country Inns sales rose 166,3% in the year to end March 2022

Hotels

- Forest Holidays sales rose 138.5% in the year to end February 2022
- Peel Hotels sales rose 92.9% in the twelve months to end January 2022

- The Manor House Hotel (Castle Combe) sales rose 125% in the twelve months to end March 2022

Leisure

- Hippodrome Casino sales rose 83.1% in calendar 2021
- The Columbo Group sales rose 98.2% in calendar 2021
- Zip World sales rose 182.3% in calendar 2021
- Roadchef sales rose 58.4% in calendar 2021
- Merlin sales rose 100.7% in calendar 2021

Suppliers

- Cobra Beer sales grew 25.1% in calendar 2021