MONTHLY BRIEFING REPORT

December 2022

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Introduction

In addition to my Weekly Briefing Report, which remains free of charge, I provide a premium version which includes a subscription to my Quarterly Briefing Report and Monthly Briefing Reports. You can find details here.

I would value your feedback on topics you would particularly like me to add to my coverage – you can contact me at peter@peterbackmanfs.com or 07785 242809.

If you have any comments, or concerns, please contact me on 07785 242809 or at peter@peterbackmanfs.com

A Christmas tale

It was icy, and snow lay on the ground when I arrived in the Lake District for my annual pre-Christmas week-long walking holiday in the Lake District.

And then overnight everything thawed. It became boggy underfoot, and worse; there were water traps everywhere. Stepping on a green patch, it turned out to be water-laden moss. Feet slipped and became overwhelmed by the water which got inside boots.

But I survived because I was prepared. Layers of clothing. Waterproof leggings. Sticks. Performance boots. They all helped get me through (and make the experience thoroughly enjoyable).

The foodservice market and its cousin, hospitality, or at least those parts of those markets that are privately owned and funded, are in a similar position – but notably, the enjoyable experience is absent.

What do I mean by that?

Businesses in the sector are treading on boggy, unstable, treacherous ground. But are they fully prepared?

The Ground

What constitutes the ground – and why is it treacherous? The ground, in a word, is finance and it's treacherous precisely because it's unprepared.

I'll take three elements of the financial ground – severe pressure on profits, accessing affordable funding, and investment.

Pressure on profits

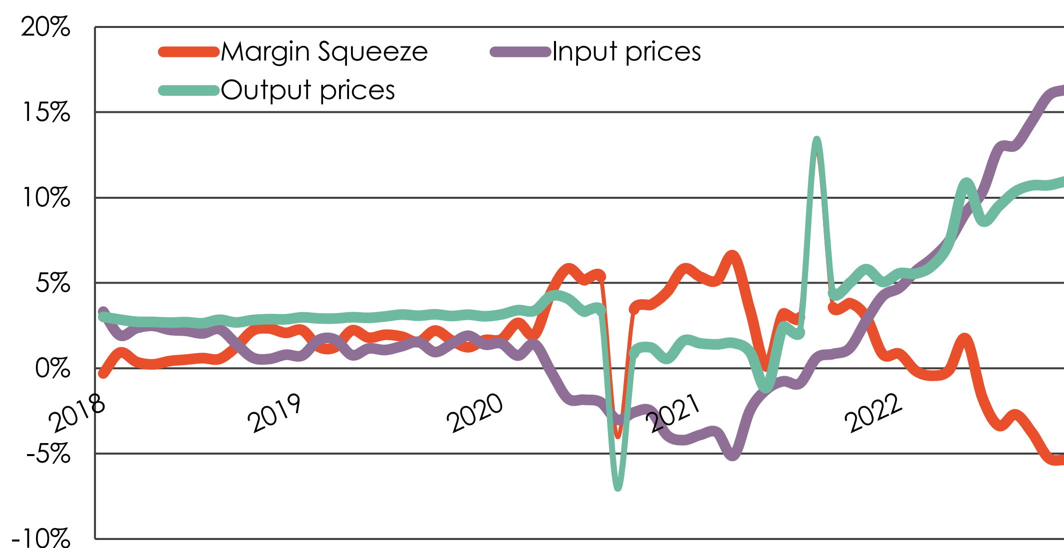
In the two years up to the start of covid, the prices that operators charged their customers grew by about 3% a year. And the cost of the food and drinks they bought rose by about the same

amount over the full two years (although the difference was a bit less in 2019 than the year before).

Since costs had risen by less than sales, there was a little bit more profit at the end of every month. Things were looking comfortable for operators.

Then during covid, the position became less clear (partly because the data are less clear). But the evidence is that during 2020 and most of 2021 costs were low and falling, while sales were rising.

Margin Squeeze



Source: ONS; Peter Backman

The result was even more profit available for distribution to owners, and for those who were expecting hard times ahead, funds to support the business in those forthcoming hard times.

And then towards the end of 2021, things changed dramatically.

Sales rose – but the costs of food ingredients and drinks rose much faster. The profit that had built up was wiped out in a matter of months. But even so, the process of rising costs, falling sales and the subsequent need to draw on saved profits continued; and as a result borrowings grew.

And they are still growing. So long as they can continue to grow, there is some security for operators (it's more complicated than that of course because it depends on lenders still being prepared to lend, and borrowers still willing to contemplate the costs of borrowing, and their ability to pay back what they've borrowed).

But the bottom line is that financially, operators are weakened, and they are not likely to see the normal boost to profits over the festive season.

The outlook for many is very gloomy.

Accessing affordable funding

One way of making the outlook less gloomy is having enough money in the bank to see the business through the coming tough times.

But. Recent research by the Federation of Small Businesses showed that small businesses are experiencing severe difficulties in accessing loans. This research, admittedly, includes many non-

foodservice, non-hospitality related businesses, and therefore in its totality does not speak only for those sectors. But, on the other hand, most foodservice businesses are small and medium-sized and therefore the research may be reasonably representative of much of the foodservice business.

And the FT reports that, in the autumn quarter this year, just one half of loan applications by small businesses were accepted; this compares with the acceptance of two thirds of loan applications in the period up to the onset of covid. And further, in a third of cases when loans were offered, they carried an interest of more than 10%.

And this growing level of interest has been piled on top of loans to small businesses totalling £203 billion – up from £167 billion just before covid, an increase of 21.6%.

Thus small businesses, whose (aggregate) borrowings have increased by more than 20% over the last two and a half years, are finding it difficult raising additional loans (about a half have been rejected in the third quarter). And when loan applications are successful, the borrower has to pay high rates of interest.

This is an unsatisfactory position for any business and especially for one that is already in a parlous financial state.

Investments

Stock markets around the world have been on a years-long investment roll. Valuations and deals have been driven to very high levels. And investments in IT have led the charge.

But since last summer, that has changed.

International M&A activity has slowed dramatically because, under tightening monetary conditions and reduced investment sentiment, funding has not been available – or when it is available, the terms of the deal have not been acceptable either to investors or the businesses involved (or both).

Consequently and at a macro, very elevated level, global M&A activity fell in value by -36% from the first half of 2022 to the six months to December – and over that period, the volume of deals fell by a similar, if slightly smaller, -28% in the whole of 2022 compared with 2021.

Reaching down more specifically, investment in the tech area (starting with the biggest companies, Meta, Amazon, Google and the like, and extending down to the smallest tech start-up) has been increasingly hard to find.

This is being driven partly by the wider issues around investment and partly through a realisation that tech may not be the route to financial riches that many believed it to be. It could be that reality about the investment-potential of the tech sector has stepped in.

But whatever the reasons, this slowdown in investment activity affects the largest companies. But it has a greater impact on smaller companies which have fewer avenues for raising investment.

A large company, for instance, can issue bonds, while this is into an option for smaller companies.

But why should these issues which, after all, concern large companies and the tech sector in particular, concern the foodservice sector? First, the sector needs investment for day to day capital-raising, balance sheet-supporting reasons.

And second it needs investment to move ahead whether through estate expansion, M&A, capex, or for one of many other multiple ways in which businesses grow.

And to that can be added investment sought by founders (or current owners) who for whatever reason, are looking for an exit.

In short, any reduction in the overall availability of funds will have an impact on the foodservice sector.

And a very specific area of investment for the foodservice sector is delivery. I have frequently commented on how delivery saved the sector during covid, and how it is proving a useful (in some cases merely helpful, and in other cases crucial) way of growing a foodservice business (whether it is an operator, dark kitchen, or virtual brand).

As I have discussed in theDelivery.World on several occasions, in investment terms delivery is positioned as a tech opportunity. Now that tech is not the investment-pull it once was, there must be concerns over the longer term attractiveness of investment in the essential, but loss-making last mile delivery services that oil the wheels of restaurant delivery.

Thus in summary, sourcing funds for investment in the delivery sector, and the wider foodservice and hospitality markets, is under pressure, and although funds will return in the longer term that is of no consolation to businesses seeking investment right now.

Pulling this together

I have identified three financial pressures that face the foodservice sector right now:

- Pressure on profits
- Accessing affordable loans
- Reduced appetite for investment

In good times these are pressures that either do not exist to any major extent or, if they do, they can be fairly easily overcome.

But these are not good times. Nevertheless, is there a glimmer of hope?

Year-end trading

The Christmas period is traditionally a good time for restaurants, pubs, and hotels. It's when customers come in their droves, spending perhaps more than they intend and it's a time when operators can charge a premium for their offer.

In normal times, cash builds up from late November until the end of December. And this cash is generally used to defray the cash squeeze encountered in the dog days of January and February.

But this year has been different.

First, it follows two years of low Christmas trading.

Second, as I have noted earlier, cash reserves are already low.

Third, customers' finances have been, and continue to be squeezed for many reasons recounted in detail elsewhere (so I shan't go into them here).

Fourth, current social conditions – from strikes to the need to reduce expenditure on petrol - have led to a reduction in eating out.

And there is an ironic, fifth reason too. Despite the difficulties and headwinds that they are facing, businesses are still open, and customers still want to spend their money. But the irony is that many operators are unable to fully satisfy that demand.

I have an example. There is a wonderful pub in the village of Broughton Mills in Cumbria. They can serve 50 customers in a day. But over Christmas they had to restrict the number to 35 because they couldn't find the staff to cook and serve for any more.

And on top that they had to close off one of their two dining rooms because the cost of heating more than one dining room was too high. This meant a further reduction, to 25, in the numbers of guests they could serve.

The result is that by serving 25, not 50, guests they will halve their sales this year, while their costs are rising steeply.

So there will be no festive profit this year. And no festive profit means nothing that can be carried over to help with financially stretched January and February. And that is without anticipating the higher energy bills that will arrive in April when the government halves its support.

Far from a glimmer of hope, disaster looms.

Now, this is just one story amongst many thousands. This particular pub has strong management (in both the operational sense and the strength of purpose), and along with many others I think it will fight through to the other side. But too many won't.

The outcome

Bringing all this together then, it is crucial to acknowledge that Christmas trading is vitally important for most foodservice operators.

Writing in my previous Monthly Briefing Report for November, I was fairly sombre about the prospects for December 2022. And I fear that I may have been right.

How has it been? Figures are not yet coming through, but anecdotally an unreasonable number of forward bookings were, as I feared in November, not confirmed. Even so trading in December seems to have lived up to its forecasts – it's been just about OK but nowhere near good enough.

This is bad news for weak businesses, many of which will be going to the wall over the next few weeks.

And the industry in general, having been weakened over the past two or three years, is in no condition to fight further financial pressures. But fight it will have to. And fight it will

The remainder of this Monthly Briefing Report contains a very brief summary of corporate activity over the medium and long term that has been reported in the past month.

News in the month

Restaurants

- Rockfish sales rose 156% in the year to end April 2022 versus the prior year
- Hawksmoor sales rose 74% in calendar 2021 versus 2020
- Rick Stein sales rose 89.3% in calendar 2021 versus 2020
- Giggling Squid sales rose 94.4% in the year to early April 2022 versus 2021

QSR

- H&S Restaurants sales rose 64.6% in calendar 2021 versus 2020
- PA Crocker sales rose 55.0% in calendar 2021 versus 2020
- AG Restaurants sales rose 67.8% in calendar 2021 versus 2020
- Caspian Networks sales rose 47.0% in calendar 2021 versus 2020
- Pizza Union sales rose 121% in calendar 2021 versus 2020
- Wingstop UK sales rose 182% in the year to end March 2022 versus 2020

Pubs

- Stange & Co sales rose 148% in the year to end February 2022 compared with the prior year
- ETM Group sales rose 220% in the year toe nd February 2022
- Tynemill sales rose 147% in the year to end March 2021 versus the prior year
- Admiral Taverns sales rose 180% in the year to end May 2022 versus the prior year
- Drake & Morgan sales rose 590% in the year to end March 2022 versus the prior year

Hotels

- Goring Hotel sales rose more than 700% in the year to end March 2022 versus the prior year
- Sleeperz sales rose 266% in the year to end February 2022 versus the prior year
- Utopia Leisure sales rose 49.6% in the year to end March 2022 versus the prior year
- Oysterfleet sales rose 173% in the year to end April 2022 versus the prior year
- Luxury Family Hotels sales rose 57.1% in calendar 2021 versus 2020
- Morgans Hotel Group sales fell -73.5% in calendar 2021 versus 2020
- Crazy Bear sales rose 135.3% in the year to end June 2022 versus the prior year
- The Nettleton Collection sales rose 66.3% in the year to end March 2022 versus the prior year