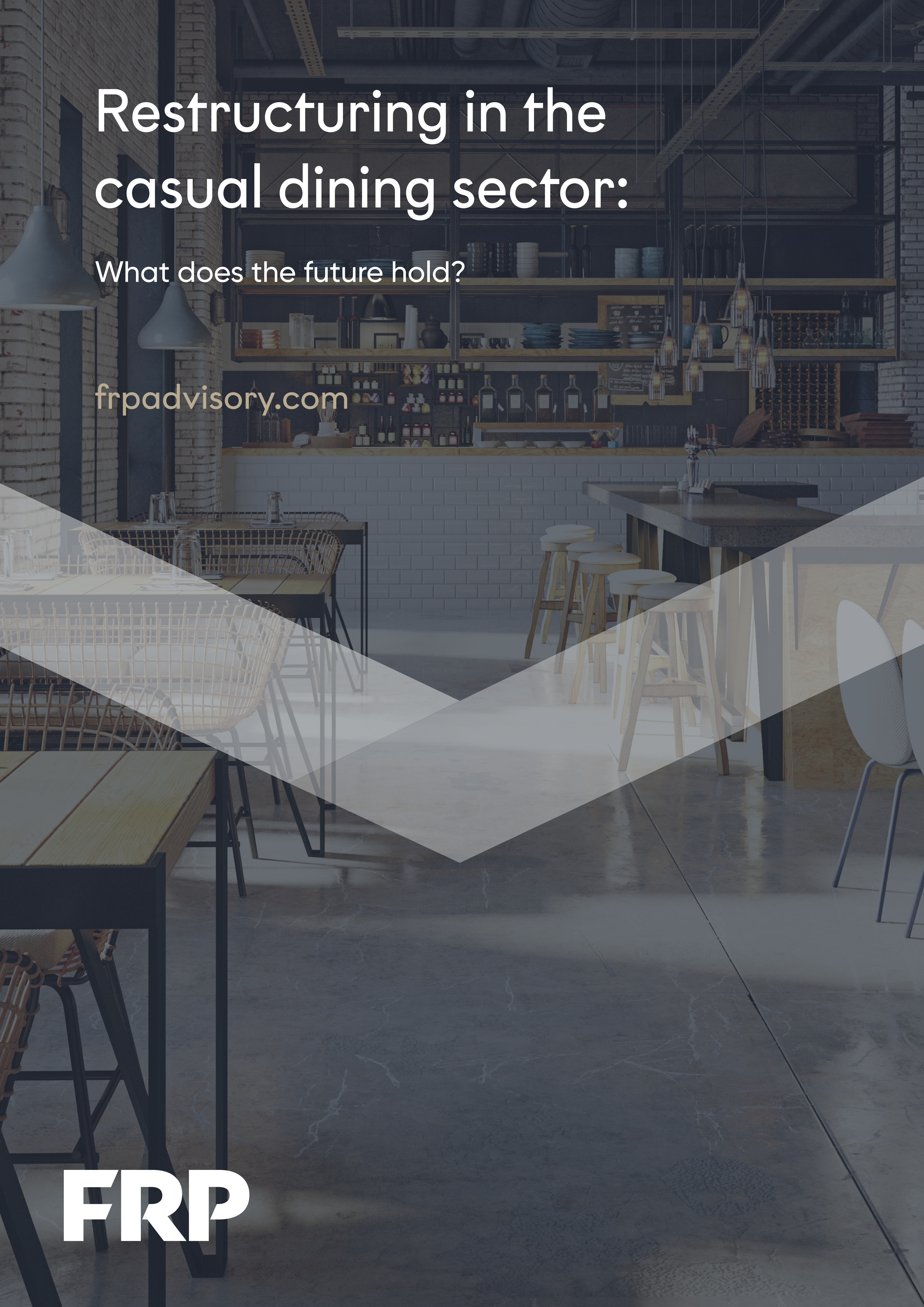

# Restructuring in the casual dining sector:

## What does the future hold?

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>
> Phil Reynolds
> Restructuring Advisory

Publication

# Restructuring in the casual dining sector: what does the future hold?

## Synopsis


The UK casual dining sector enjoyed many years of strong growth over the last decade, but more recently it has become a far more challenging operating environment. Prior to the pandemic, a 'casual dining crunch' had seen a number of high-profile failures, as an oversaturated market, changing consumer tastes and Brexit challenges exposed the vulnerabilities of some chains.

While many have responded to the crisis with great dynamism, national lockdowns, local restrictions and a raft of new regulations have kept up pressure in the sector. The Centre for Retail Research reports that almost 30,000 jobs were lost across fine dining, independent businesses and multiple large casual-dining chains during 2020, up from 11,280 the year before*[1].

Here, we explore the specific challenges the sector is facing, as well as the positive steps businesses can take both immediately and in the longer term.



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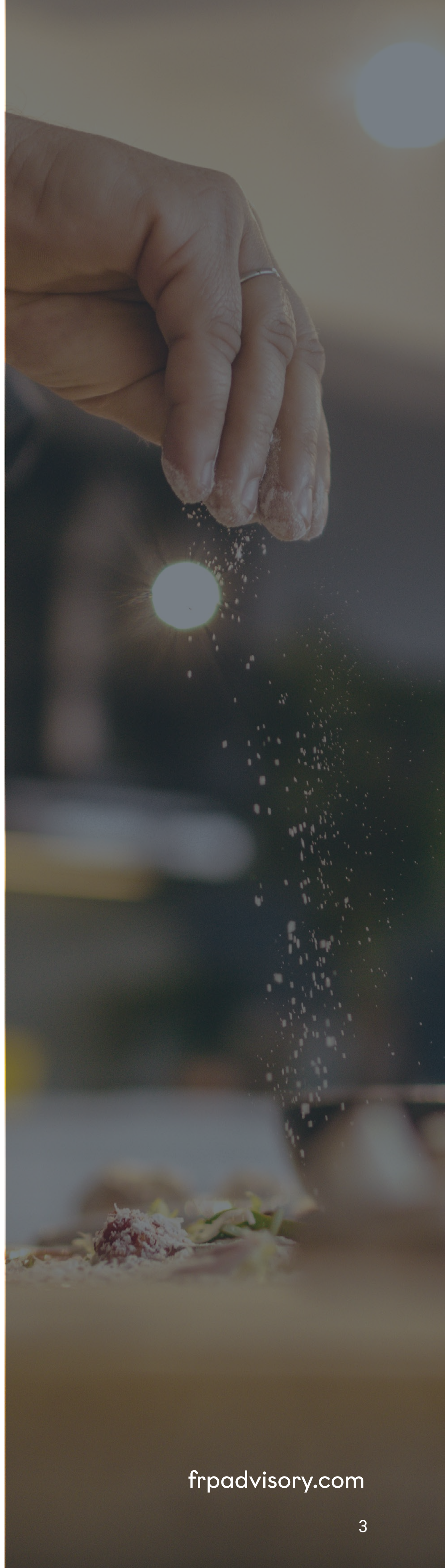

## What is the current state of play in the UK casual dining sector?

Some of the government support mechanisms have been helpful, but operators are still accruing liabilities during lockdown. This includes rent for premises, which are either closed or facing substantially reduced operations as a result of pivoting to a take-away model. With this in mind, there is nervousness from businesses over how they are going to bridge the gap between now and reopening later this year.

We've seen a general shift towards turnover rent – or a hybrid model with an element of fixed costs – combined with a general trend towards shorter leases, or the inclusion of more breaks. Whilst these trends help to ensure that the tenant's rent flexes with activity levels and allows an easier exit from underperforming sites, it can mean that for those sites performing well on short tenancies, the tenant's negotiation position will be weaker on renewal.

However, mergers and acquisitions (M&A) continue across the sector and there have been successful rescues from distress, which provides reason to be optimistic about its future.

> Lockdown has also helped accelerate the transfer of power between restaurants and delivery services.
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> Restructuring Advisory

## How has the COVID-19 pandemic impacted the sector?

Most restaurants have had to close their doors and furlough staff, and so we've seen lots of operators diversifying their offering by providing takeaways or home-cooking kits. This shift suited a lot of brands that already had central kitchens serving multiple sites, and there has been a growing trend towards dark or virtual kitchens – operating a kitchen location without a dining room – through to multi-brand dark kitchens, and dark kitchens owned by food delivery aggregators.

Lockdown has also helped accelerate the transfer of power between restaurants and delivery services – presenting challenges for the former. The three main delivery companies – Deliveroo, Just Eat and UberEats – typically charge restaurants between 14-30 per cent of the order total. A recent independent analysis estimated that the three main takeaway ordering platforms secured more than £1 billion in annual fees from UK restaurants.

For smaller independents, this margin loss is unsustainable and is leading some to move back to running their own delivery models. However, businesses face the challenge that their customers might remain with big aggregator platforms, and they could miss out on business as a result.

There was a mixed view from the sector on the 'Eat Out to Help Out' scheme, which enabled operators to offer discounted meals on Mondays, Tuesdays and Wednesdays during August 2020. While this gave the trade a big cash boost, it was also operationally disruptive. Some restaurants found it simply shifted trade from weekend to midweek, causing staffing issues, and most may have preferred a smaller discount spread over more days – a decision that would have diluted the Government's policy to shift behaviours.

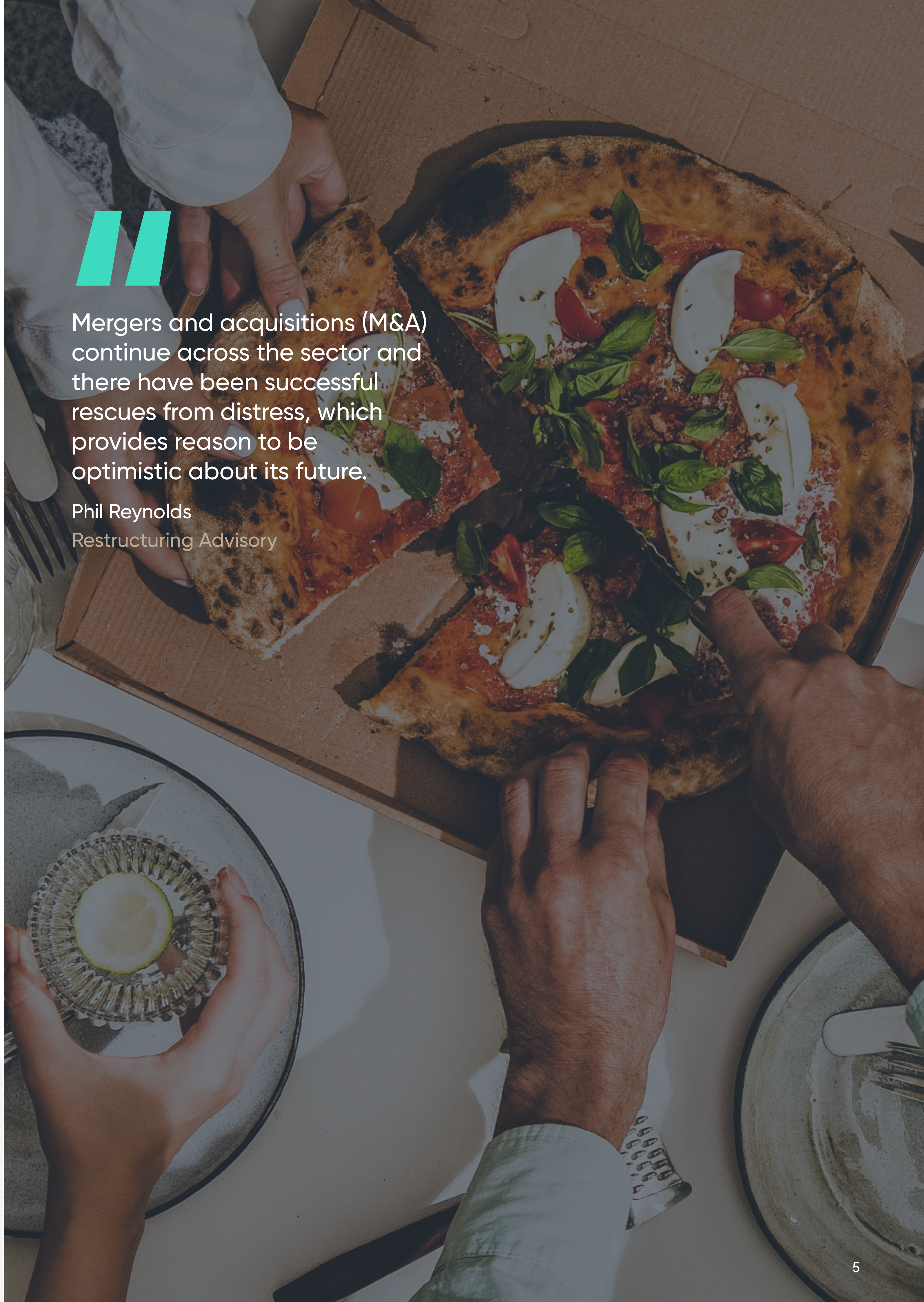
A positive that we can take from the last year is that it has encouraged chains to restructure and reshape their portfolios, addressing sites that were struggling pre-COVID.

Notes

*1 Saker-Clark, H., 2021. Almost 30,000 jobs lost in hospitality sector in 2020. [online] The Independent. Available at: <https://www.independent.co.uk/news/business/news/covid-job-losses-hospitality-restaurants-b1781655.html> [Accessed 24 March 2021].

*2 Kubik, P., 2019. Restaurant insolvencies jump 25% in the last year alone. [online] UHY Hacker Young. Available at: <https://www.uhy-uk.com/insights/restaurant-insolvencies-jump-25-last-year-alone> [Accessed 24 March 2021].





## What issues are businesses in the sector facing?

The biggest challenge is trying to predict when activity may resume. Recent announcements of a roadmap out of lockdown have been helpful, although there is a significant proviso attached to the timetable. Every time lockdown forces restaurants to close, all perishable dry and wet stock has to be replaced, resulting in substantial costs and creating further difficulty for the sector.

Operators have had forfeiture protection from landlords, who haven't been able to evict tenants, and some businesses will not have paid rent for more than a year. This has provided some relief. However, the ban on commercial evictions will end in June, which could result in restaurants scaling back to manage the resulting costs, if payment terms can be reached. The government is consulting on how they can support matters post-June, but have stated that no further automatic protection will be granted.

Businesses could be in a better position to repay outstanding rent from 2020 if it was established that rent could be repaid gradually over the next two years – ultimately, if repayments are met, businesses won't be at risk of any action.

## How is the supply chain for the sector impacted? What challenges are facing the supply chain?

There was a lot of concern over the effect that Brexit would have on the sector's labour supply. This remains a long-term issue, but so far, due to lockdown, the impact has been muted.

Looking at wholesale suppliers, many have had issues with bad debt. They have moved to protect themselves and many larger chains have had to provide guarantees from their lenders or parent companies that their liabilities will be met. Many wholesalers will also have seen large falls in their sale volumes. However, the impact on main suppliers has not been as severe as might have been expected, with businesses able to pivot quickly to adapt.

## What should firms be doing to prepare for the new economy?

Firms should act now to ensure that contingency plans are in place and ready to provide the flexibility necessary to cope with any future national or local lockdowns.

If they haven't already, business leaders should be aiming to reach an agreement with their landlords, so they have a basis on which to continue operations, when they are able to. There is a suite of options available, including a straight rent reduction, a move onto a turnover basis for a set period, or a hybrid of the two. Entrepreneurial landlords may well be happy to consider turnover-based rent, although this will very much depend on tenants' projected income levels.

Firms should also build as much flexibility into their cost base as they can. The '10pm curfew' caused difficulty for a lot of operators as they were unable to serve two sittings. With this in mind, some have sought 'curfew guarantees' from their landlords which, in the event a curfew is imposed, would give them immediate rent relief.

Even once the vaccine has been fully rolled out, it's likely that an element of social distancing will persist for some time. Social distancing measures have led to restaurants offering a reduced menu, which has brought its own benefits, including less waste and better margins. With this in mind, careful menu planning will be key to ensure that businesses continue to benefit where they can.

> During lockdown, a number of chains have successfully worked out the logistics of offering takeaways and meal kits from dark kitchens.
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## What trends do we anticipate seeing across the sector over the next 12 months and beyond?

2021 will be a reset year for the sector. As the economy re-starts, businesses will face the immediate challenge of meeting the working capital requirements of re-opening. The new government-backed Recovery Loan Scheme may provide a vital lifeline to help them trade back into profitability, however business' ongoing success will be affected by how well the economy recovers from recession and levels of disposable income among would-be diners. If individuals have less money to spend, then eating out could slip down the priority list. While there is some optimism that trade will return, driven by the vaccine and pent-up demand, location will be important.

Sites that have already closed or been sold are predominantly on secondary and tertiary high streets – locations that have also seen a number of businesses in the retail sector close. It is likely that this will, in turn, lead more people to shopping centres, which provide entertainment and dining experiences on top of retail options. Food courts could be a way forward for the sector, as multiple operators can share operating costs like cleaning and maintenance but retain their own proposition.

During lockdown, a number of chains have successfully worked out the logistics of offering takeaways and meal kits from dark kitchens. Central kitchens are a good way to reduce costs, and could mean that businesses can reduce the overall kitchen space they need to build into new, future premises, allowing them to serve more covers. However, the question will be whether businesses can retain a dark kitchen and continue to achieve good margins for their business once lockdown ends.

This will lead to new opportunities as landlords won't want to see sites empty, and so may be open to striking deals with far more flexibility and tenant incentives. There will be a lot of sites coming onto the market that are already equipped for use as a restaurant, which will mean lower start-up costs and less risk, bringing down barriers to entry to the market.

Pre-COVID, there was a rush of private equity in the sector with rapid expansion plans, which left high streets looking increasingly homogenised. However, this could change – there currently appears to be a consumer shift back to the independents or small chains as diners look for something different.

**1**

Billion pounds in annual fees paid by UK restaurants to takeaway platforms

**30,000**

Jobs lost across the fine/casual dining industry in 2020

**30**

Percent of order total charged to restaurants by delivery companies



## Conclusion

The casual dining sector was already a challenging operating environment before the pandemic, with more than 1,400 insolvencies in the sector from June 2018 to June 2019*[2], and multiple high-profile failures and restructures making the news.

While there will likely be a rush for tenants and landlords to agree deals for any outstanding liabilities while forfeiture protections are still in place, we are likely at the end of a current run of formal restructuring activity – most of the larger operators in the sector that have needed to formally restructure have already done so.

How and when the sector bounces back will depend largely on the performance of the wider economy and the full rollout of the coronavirus vaccine, both helping to restore consumer confidence. Operators are building more flexible relationships with landlords based on shorter tenancies and turnover rents, which could be more sustainable in the long-term.

But lockdown has also accelerated the ongoing growth of a disruptive new power in the sector – home delivery companies. While they do represent a useful route to market for many restaurants, charges of up to 30 per cent mean they take a significant slice out of operator's profits, which may prove to be unsustainable, especially for smaller independents.

For every chance of success, flexibility and proactive early engagement with stakeholders will be key.

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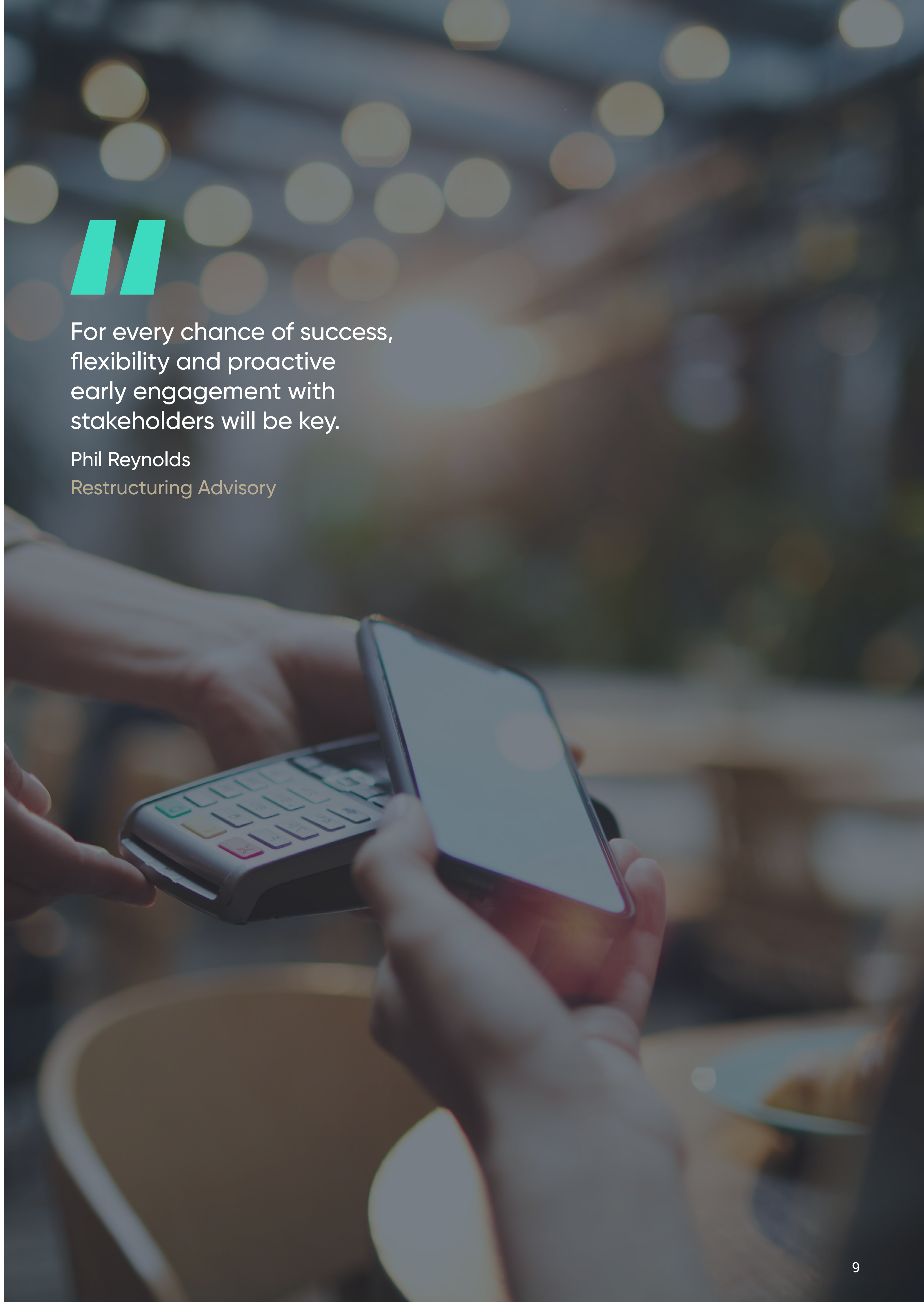

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