

The out of home food sector: what does the future look like?

A guide on the likely drivers of success post-lockdown

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About this report

Quantuma and COBA have come together to look at the factors likely to impact the performance of the out of home (OOH) market as we look to a 'new normal'.

The sector faces severe challenges

As the UK reopens its out of home (OOH) food sector, we describe the trends that are likely to develop as well as the key factors that are likely to determine success – or indeed survival. We wanted to make sure we checked the industry's pulse – and were very privileged to speak to Stephan Croix. Stephan is an independent, industry leader with many years of experience helping brands grow and restructure and has held chief marketing officer positions at Yum Brands and Starwood Hotels.



Stephan Croix

Leading industry expert, with C-Suite experience from Yum Brands and Starwood

Quantuma

Quantuma is a leading business advisory firm which provides expert advice on business transactions, assists in resolving disputes and helps organisations as well as individuals overcome a range of operational and financial challenges.

Quantuma works closely with businesses at key milestones, enabling them to achieve their objectives and ambitions. Providing a partner-led service, Quantuma has 18 offices, including 15 in the UK and two international offices in Cyprus (Nicosia and Paphos) as well as one in Mauritius.



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Jonathan is a transaction services specialist with expertise in transactions advisory, including financial due diligence, valuations, vendor due diligence and initial public offering working capital reviews. Jonathan heads up the financial due diligence and valuations practice as part of Quantuma's corporate finance team and has over 25 years of experience working on deals for private equity houses, sovereign wealth funds, corporates and family offices.

COBA

COBA is a group of specialised strategy and operations advisers and operating partners, working with leading executives to support mergers and acquisitions (M&A) in selected sectors.



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Daniel is a partner at COBA and specialises in helping investors acquire, grow and restructure assets. Daniel has 30 years of experience working for PE funds and acquisitive investors across EMEA.

We are positive but only in the medium-term and for the market overall

Overall, we do not agree with some of the more pessimistic commentators. People want to get out, eat out, enjoy the restaurant experience again and...not wash up. Over time, the sector will regain and perhaps increase its share of consumer pocket. Nonetheless the path will be stony for many players. The various supports put in place by government may mean that marginally more players will be able to walk this path – but don't change the fundamentals.

“The world is entering its biggest economic crisis in half a century. The impact on the OOH food sector is significant and will drive fundamental changes in the industry. Over the next six months, we expect the market to consolidate, consumers to continue to shift their behaviour driving a change in the share of stomach of every format, and new players to enter the market.”

Stephan Croix

There will be significant structural changes – one of these will be rapid consolidation

The lack of clarity for consumers and predictability overall will compound the challenges in the sector. It is natural that people are wary of public spaces and contact with others. This will drive consumer spend towards formats that minimise this, at least in the short-term. Full-service restaurants could suffer for some time. At the other end of the 'contact' scale, restaurants that can deliver will enjoy increased consumer demand, as will those who offer take-away, curb side pick-up or even drive-through options. This will clearly favour quick service restaurants– especially as they benefit from a younger and perhaps more adventurous customer base. Finally, we anticipate that the development of 'dark kitchens' will also accelerate, as this offers new and existing restaurants a way to fully tap into the delivery market, at reduced costs.

A further factor to consider is the coming recession. Our view is straightforward in that consumer spending in the UK will be challenged. The medium-term impacts of the pandemic, compounded perhaps by Brexit, are very negative. We think that expenditure in the wider food/restaurant sector will be prioritised by consumers – which is positive. Nonetheless, we will see an increasing focus on value and, like-for-like, this will drive ticket price down, unless restaurants are able to compensate with smart up-sell and cross-sell tactics or by increasing the frequency at which consumers buy. We believe that in three years' time the mix of outlets on offer will be markedly different. But there will also be other

structural changes to the supply of restaurants. These will include strong consolidation as smaller operators will find it more difficult. More generally, the UK was in oversupply of restaurants pre-2020, and the Coronavirus (COVID-19) pandemic has just accelerated the rationalisation trend.

There will be, sometimes heroic, exceptions to the trend. Pubs may do better than other full-service environments as the British consumer is deeply attached to this format, and of course, we all hope that nice neighbourhood eateries survive. However, they clearly will need to be doing something special in order to do so.

“Pubs may do better. Many are building outside space which is perceived as safer, and it is already difficult to find space to eat in the next few weeks.”

Stephan Croix

Six key success factors, especially over the short-term

1 Food safety and hygiene

Firstly, restaurants will need to offer a customer experience that is consistent with regulatory guidance and reassures customers. This has implications for all aspects of restaurant operations.

Examples:

- Front of house infrastructure and staff processes – table spacing, check out screens, sanitization, cashless payment.
- Back of house processes – food preparation, serving, ingredients, etc.
- Menu redesign – critical to ensuring meals can be prepared with new rules on staff spacing, reduction in contact etc.

The menu redesign point is key and will require care. ‘Self-service’ options such as buffets or drinks refill stations are being dropped by most restaurants to reduce the risk of contamination. McDonald’s in the United States has decided to remove salads from their menu to simplify their operations. Simpler operations translate into better, safer and faster execution of the menu, and therefore, higher customer satisfaction. Despite the importance of salads in building a healthy brand, salads may not return onto the McDonald’s menu anytime soon.

2 Customer experience

Secondly, operators will need to ensure that the customer experience is still exciting and drives purchase. This is particularly crucial for full-service restaurants, as they are competing with fast-developing delivery options. This ranges from creating a unique ambience and service proposition that is appealing to consumers, to digitalising the experience - for instance, replacing high-touch areas such as menus by digital screens or a more traditional but very personable chalk board. Some operators are also investing in increased outdoor spaces or in new ‘click-and-collect’ or ‘drive-thru’ experiences for their customers. The customer experience increasingly extends to the online world, and restaurants need to ensure that their websites are easy to use, fast to load, and tell a great story about their brand and their food.

3 Marketing and communications

A critical point is clear and frequent communication, as well as an investment in marketing, especially online. Consumers are nervous and on the most basic level, they will need reassurance as to the safety precautions being taken. On a more granular level, upon reopening consumers will need to know what is open at what times and how they can access the restaurant.

In addition, restaurants will need to invest in marketing to stimulate demand again – arguably, more than before the crisis. This is also the opportunity for restaurants to shift their advertising efforts to digital marketing, which will allow them to acquire new customers and stay in touch with existing customers in real time and with a much stronger return on investment.

4 Revenue management

Operators will need to really improve their revenue management and pricing discipline, particularly in the context of increased cost and lower densities due to security measures. We believe consumers (perhaps because favourite brands and activities have not been available) are markedly more willing to try new brands. They will be targeted by value offers and promotions – and this will mean that restaurants will need to find clever ways to drive spend. This can link to the menu redesign and customer experience – digital menus allow automated up and cross-selling options, for example.

“COVID-19 has sort of shuffled the deck; consumers have shifted their behaviours like we’ve not seen in the last few decades. They are willing to try new brands but are also worried about money. Therefore, we expect restaurant brands to run value-led acquisition strategies, driving tickets down – so they will also need sophisticated pricing strategies to defend margin, such as up-sell, cross-sell, new product development and menu innovation. These will be even more critical.”

Stephan Croix

5 Delivery

And let's not forget...delivery, delivery, delivery. This trend is growing even faster than pre-crisis and could be a lifeline for many restaurants as it will help generate incremental revenues, attract new customers and potentially even increase frequency of consumption. Of course, this has many implications for the restaurants, ranging from back of house operations to menu adaptation, packaging design to ensure food can be transported easily, stay hot, not spill etc. driver or delivery partner management, and marketing.

6 Financial robustness

Debt and working capital issues will be another key factor in determining who will survive and be successful. Businesses in the OOH food sector, like many in other sectors, are likely to be loaded with levels of debt which would have been unthinkable before lock-down and unsupportable if interest rates were not close to zero. A report from TheCityUK's Recapitalisation Group* last month predicted that UK businesses would have £100 billion of unsustainable debt by March 2021, with around half of this owed by small to medium-sized enterprises.

In addition to the usual forms of bank debt, overdrafts, hire purchase etc, debt may take the form of government schemes such as the Bounce Bank Loan Scheme and the Coronavirus Business Interruption Loan Scheme. In addition, many businesses have taken advantage of the opportunity to defer payments to HMRC such as VAT, corporation tax or PAYE. They may also have missed rental payments or mortgage repayments, possibly leading to penalties or other contingent liabilities. They may also be delaying payments to

their suppliers. Trade creditors are usually treated as working capital, but if these are long overdue they are really another form of debt which needs to be deducted from the business's value. Many of these debt items may not have been fully reported on the companies' balance sheet.

These key success factors will drive the consolidation

There has been a lot of comment on how 'localism' will be a key trend. We think this view needs to be nuanced. People will eat out closer to home more often – as working from home is now well established. This could shift demand out of city centres. However, we do not agree that local restaurants will be beneficiaries. Scale, management resources and brand will be key.

Larger players will be able to do complicated things better; for example, customer experience and revenue management. They can also do 'simpler' things cheaper, for example insource delivery or obtain better conditions from delivery platforms, or acquire protective equipment. They will have the resources to communicate intensely and doing this in conjunction with a brand with high notoriety will increase the impact. They will, or can have, strong CRM platforms in place, which will allow them to build stronger relationships with customers. This will also facilitate the overriding aim of optimising cash flow, by increasing the average basket size, creating ancillary revenues, or introducing loyalty and prepaid cards for example.

Bigger players are better equipped for the challenges; they are also more likely to be able to demonstrate this. Being

able to show that future earnings will be sufficient to pay off accumulated debt and reward new financing will be perhaps the most important success factor.

"There is no doubt that the sector faces headwinds, but there will also be winners. These will be operators who are able to offer consumers signature dishes and experiences at a great value, whilst also adapting their menus to capitalise on the fast-growing trend of delivery. Of course, a prerequisite for survival will be to put reinforced food safety and hygiene protocols at the heart of operations, whilst communicating those changes effectively to consumers. I believe this will favour the larger players."

Stephan Croix

If you would like to discuss the specific key success factors to maximize the returns for your investment in the sector - we would be pleased to meet with you. Please do get in touch with Jonathan or Daniel by email or phone.



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* Source: CityUK Recapitalisation Group Interim Report www.thecityuk.com/research/recapitalisation-group-interim-update