PUBS

2018 may be the turning point for the British Pub. The total turnover from pubs has remained similar to that in the heady days of 2008 as today's pubs and bars have generated new business and absorbed the trade from those that closed.

NEIL MORGAN
Managing Director
Pubs & Restaurants

After 10 years of issues, ranging from the loss of 11,000 pubs in that period, friction between tenant and landlord, assets of community value and the changing demands of the consumer, we feel the love for the pub may be returning.

The number of UK pubs has declined by around 28% since 1989. Generally speaking, those that still remain are more viable and sustainable trading businesses. Some market churn will continue, as many managed companies will look to convert underperforming assets into their existing franchised or leased operations. Private operators will also benefit from a number of national and regional companies' individual asset disposals throughout the year.

M&A activity was sporadic throughout 2018. The acquisition of Hawthorn Leisure by NewRiver in May 2018, which brought NewRiver's total portfolio to 629 assets, was the largest single transaction the market had witnessed since Admiral Taverns acquired Punch Taverns in late August 2017. Outside of these big deals, interest from private equity remained strong, with Aprirose, Alchemy Partners and TDR Capital (through Stonegate) all acquisitive throughout the year, whilst a number of operators saw more opportunity in the pub sector than in the restaurant sector, such as The Restaurant Group, which acquired Ribble Valley Inns. Stalwarts, including Fullers, Marston's and Punch Taverns, acquired small portfolios in package deals, whilst relative newcomer, Brewdog, acquired Draft House in a move that not many would have predicted.

COST PRESSURES

Rising operational costs are nothing new to the sector and have been testing operators since before the introduction of the National Minimum Wage in 1999. Today, it is an even more complicated landscape, with average overheads now eating up 52.5% of net revenue, up 3% in just two years. Wage cost inflation on the back of legislation is largely to blame, with the National Living Wage, apprenticeship levy and pension auto-enrolment all contributing to significant rises.

Property costs, primarily rent and rates, are the other key contributors to rising operator costs. High street rents in particular saw sustained inflation from 2014 through 2017. Following the wave of CVAs on the high street that began in early 2018, rents have shown signs of returning to sustainable levels, with reductions of up to 30% becoming commonplace.

Equally, the business rates revaluation, which came into effect in April 2017, was a big hit for many businesses, although increases have now largely been absorbed. Industry bodies have been relentless in campaigning for an overhaul to the archaic and unfair revaluation system. The last four budget announcements have acknowledged its fundamental problems, from the introduction and extension of a relief program specifically for pubs, a more frequent three yearly revaluation

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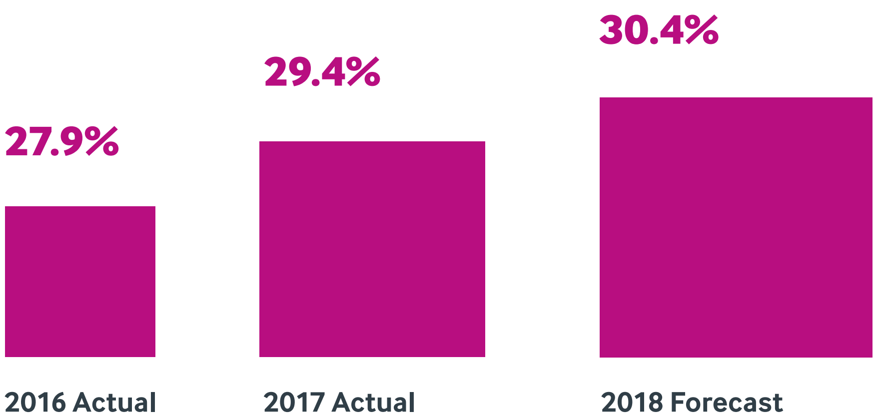
PUBS - WAGE COST MARGIN



system to avoid the huge changes seen in 2017, followed by the most recent announcement of additional reliefs that will be available to all small businesses with a rateable value of below £51,000 in the 2018 Autumn Budget.

The opportunity for operators to pass costs on to the consumer is limited in the current competitive and price-sensitive environment. Margins, in relative terms, are expected to erode further through to 2020, and marginal businesses may enter distress. The primary focus for many remains on driving top lines and sweating assets in order to overcome these challenges.

CHANGING LANDSCAPE

Whilst the overall number of pubs has fallen, the number of large pubs has grown significantly since 2001, resulting in a net increase in the total trade area, with a substantial increase in those pubs employing 25 to 49 people as pubs get larger and serve more food. These pubs and bars, many of which are independently owned by fast growing multiple operators, attract the attention of hospitality operators and private equity, as reflected in the deals we handled over the past 12 months, which have seen a wide range of buyers and sellers in both the managed and tenanted sectors although fewer in number.

New purpose-built managed houses that cater to the modern pubgoer, typically maintaining a family-friendly and all-day offering, are simply more efficient to run in a time of rising costs. National and regional operators, such as Greene King, Marston's, McMullen & Sons and JW Lees, are all investing in new builds in either prominent locations or within large housing developments..

Operators, who have embraced emerging trends, such as non-alcoholic offers, café culture, vegan-friendly options, gin and craft beer, have differentiated themselves from the competition and ensured that they have maximised their relevance to the consumer, whilst softer or unbranded operators, such as the Inn Collection Group, have reduced their exposure to brand fatigue.

BREXIT

Aside from the negative impact of some cost inflation, the devaluation of the pound following the referendum on EU membership has driven an increase in tourists visiting the UK, whilst the correspondingly high cost of travelling has boosted the popularity of staycations for those living in Britain. As such, operationally re-gearing a business towards accommodation can prove to be extremely lucrative. Pubs with letting rooms have increasingly proven themselves as capable of successfully competing with both budget accommodation providers and the boutique market, with destination pubs often being perceived as better value, whilst offering a more authentic experience. However, the sheer volume of additional room supply being developed across the UK is simply staggering and subsequently beginning to put the brakes on performance growth in some markets, such as London.

A weaker pound has also led to some additional cost inflation, although some operators, including JD Wetherspoon, have sought to mitigate costs by buying British goods, while also generating significant positive media coverage in the process.

EU nationals composed 40% of the UK's hospitality workforce as of June 2018

The referendum also dampened the influx of foreign labour, whilst encouraging some existing migrants to return home. Leading software platform, Fourth Analytics, reported that EU nationals composed 40% of the UK's hospitality workforce as of June 2018. We have seen the challenge of recruiting and retaining capable staff inhibit growth, while some companies have changed their menus in order to become less dependent on talented migrant chefs and simplify preparation and cooking requirements. Maintaining a strong and positive culture is increasingly making the difference between success and failure.

The hospitality industry has seen a 240% rise in coffee shops between 2007 and 2018.

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CASE STUDY
Ribble Valley Inns, Lancashire

Ribble Valley Inns, a group portfolio of four pubs across Lancashire, was sold to The Restaurant Group's pub-operating subsidiary, Brunning & Price, through Christie & Co in May 2018. The sites are an ideal addition to Brunning & Price's existing sites in the Ribble Valley, the Aspinall Arms and Haighton Manor, which were also acquired through Christie & Co. We have been working with Brunning & Price for over seven years now and continue to help them source suitable pubs for their estate.

CASE STUDY
Fox in Haslington, London

Christie & Co sourced and negotiated the acquisition of The Fox in Haslington via a new lease on behalf of Ego Restaurants, a Mediterranean inspired pub and restaurant brand. With the restaurant sector experiencing significant structural challenges, restaurant companies are increasingly entering the pub sector, where assets offer additional flexibility, external trading areas and reduced risk. Pub operator, Mitchells & Butlers has since acquired Ego and plans to further expand the Ego brand.

MARKET PREDICTIONS

We expect continued decline in pub numbers and estimate a further 1,000 pubs need to close within the next two years to reach a sustainable and balanced equilibrium of 47,000 pubs.

The high street will remain a difficult environment, but there will be a modest opportunity for value growth, driven by trading performance.

Investors and private equity will be more willing to consider smaller scale pub group opportunities, expanding through acquiring 'bolt on' opportunities and utilising existing management teams.

CASE STUDY
Chameleon Pubs

Acting on behalf of regional group operator, Chameleon Bar & Dining, Christie & Co sold three prominent managed houses, Greaves Park and The Keys in Lancaster and Halfway House in Shipley, to Greene King in a deal that concluded in early 2019. They intend to add these to their managed estate, increasing their presence in the area.

Movement in average prices, year on year