THE UKHOSPITALITY CHRISTIE & CO BENCHMARKING REPORT 2018

ABRIDGED

CHRISTIE & CO

UKHOSPITALITY

CONTENTS

This is an abridged version of the UKHospitality Christie & Co Benchmarking Report 2018.
For information on the full report, please contact the report authors whose details can be found on page 51

Foreword by Christie & Co	3
Executive Summary	4
1. Introduction	6
2. Response Overview	8
3. Revenue Analysis	10
4. Margin Analysis	14
5. Operating Cost Analysis	15
6. Analysis by Ownership Model	21
7. The Pubs Code	24
8. Cost Pressures 2017 and Beyond	25
9. UK Membership of the EU	26
10. Confidence and Outlook Survey	28
11. Segmental Analysis	32
12. Conclusion	46
Appendix I – Illustrative Survey Format	48
Contacts	51

Foreword by Christie & Co

This year marks a landmark year; following on from The ALMR's merger with the British Hospitality Association, this is the first year that the report has been produced under the title of The UKHospitality Christie & Co Benchmarking Report. This is also our third year of authoring the report, and the first year in which we have been able to map the evolution of the confidence that licensed operators have in the UK through comparison with the results of last year's inaugural confidence survey. We remain fully committed to continuing our support into future years, and look forward to driving the report forward with the benefit of the increased membership of an enlarged patron organisation.

This year's results reflect the continuing evolution of both the UK consumer and investor landscapes. Once again food sales have reached a new highwater mark as operators within the sector become ever more reliant on food as a driver of demand. Room revenues are also continuing to grow at a strong pace, as more operators seek to benefit from high margin letting rooms. We were pleased to see that all segments enjoyed nominal like-for-like growth in revenue during the survey period, although note that only Accommodation-Led outlets saw top line growth in real terms, due to resurgent inflation.

We also passed the peak of the investment cycle in 2017, with capital expenditure now more subdued, albeit still above the levels seen during the post-recessionary low point in 2009.

Despite this, both debt and equity remain readily obtainable sources of capital, although certain segments, such as Casual Dining, are proving more challenging due to structural issues such as oversupply of restaurant space on the back of Private-Equity-funded brand rollouts. Rent levels on the high street are thankfully now well past their peak, and should remain so for the foreseeable future.

The outlook for the remainder of 2018 and beyond is mixed. A number of political and economic pressures such as the Apprenticeship Levy and business rates revaluation are annualising, and we expect to observe the effect of this in the next report. Additionally, National Living Wage will continue to rise above the rate of inflation until at least the April 2020 increase. Of course, operators must also prepare for the challenges and opportunities arising from Brexit, which is an extremely challenging task given the prevalent uncertainty surrounding what will happen on and after 29 March 2019. Against this backdrop, the need for effective business planning is more essential than ever if operators are to thrive in both the short, medium and long term.

Christie & Co has a wealth of expertise in the licensed hospitality sector, across the hotels, pubs and restaurants divisions, and our agents, valuers and consultants alike are available to assist UKHospitality's members, and investors, with transactions, advice and business planning on both a strategic and operational level.

Ramzi Qattan
Director – Licensed Consultancy
Christie & Co

Executive Summary

Food sales and accommodation revenue driving growth

Like-for-likes average 1.1%, lagging behind inflation

This year's annual benchmarking report is the 12th consecutive edition, and will be the last based primarily on the results of a survey of the ALMR's membership. In future reports, we will strive to include the broader membership of UKHospitality. As in previous years, we seek not only to observe the trends within the industry, but also include a more in-depth analysis as to their underlying causes. Our success in doing so is in no small part thanks to the close collaboration between Christie & Co and UKHospitality, both of whom continue to contribute materially to the production of the report.

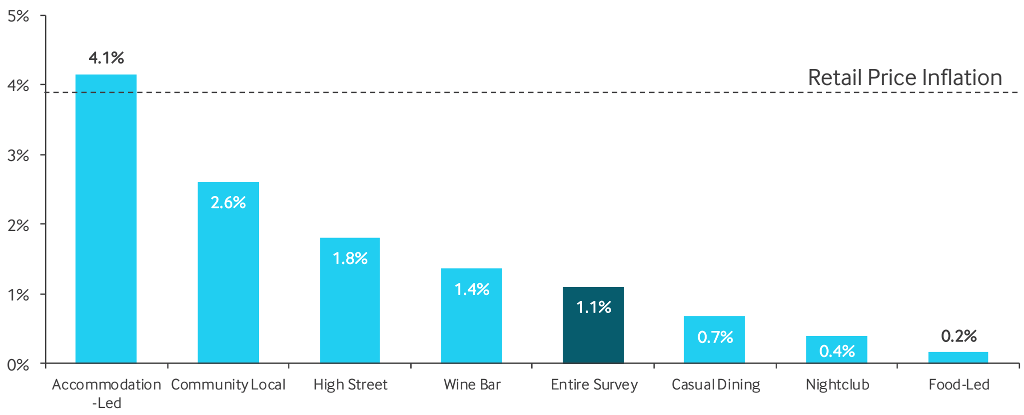
This year's report is based on results for the year ending September 2017. Our approach to conducting the survey as a simple series of questions for operators was kept in line with previous years, and we thank all those members who contributed this year.

40 companies participated in the survey, providing data covering a total of 3,548 managed outlets. Whilst marginally down on last year's number of managed outlets, the sample size is still significant enough to provide an unparalleled level of insight into the licensed sector.

Analysis of survey responses in the current year has revealed the following key trends:

- Faced with a continued shift in consumer demand, operators' focus remains on growing alternative revenue streams, namely food sales, which now account for an average 36.5% of all revenue, and accommodation sales, which now account for an average of 2.8% of all revenue
- Growth was consistent with the previous year at a nominal 1.1% over the survey period. The negative impact of a weakened exchange rate as a result of falling confidence in the UK in the wake of the Brexit referendum, and the effects of wage inflation at suppliers filtering through into overheads, caused costs to rise at a faster rate than sales, with inflation amounting to 3.9% in the period, and thus a contraction in real terms during the survey period

Like-for-Like Growth by Market Segment

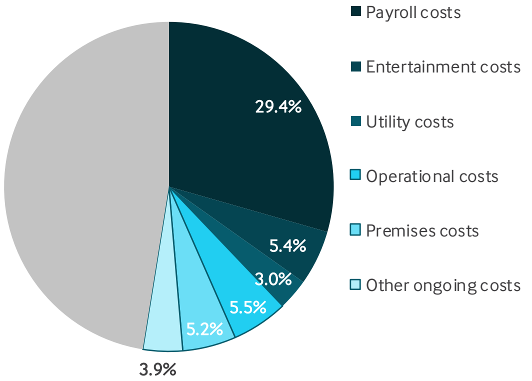


Source: The ALMR Christie & Co Benchmarking Survey

Operating costs continue to rise, with payroll the biggest component

- Capital expenditure fell 2.6ppts (percentage points) to 3.5% in the year to September 2017 and is now at the low point of the investment cycle. This is partly due to the cyclical nature of investment, but also due to a concern over returns seen on investment in certain segments, in particular Casual Dining, where supply of restaurants on the high street now outweighs demand for dining space
- The average overheads associated with running a licensed premises increased by 1ppt in the year to now stand at 52.5% of annual turnover, the highest total recorded since 2007. Results vary between segments of the market from lows of 47.6% for Casual Dining, to highs of 55.4% and 55.3% for Food-Led outlets and Nightclubs respectively
- Payroll costs remain the single most significant cost for operators, rising to 29.4% over the year. The increase in National Living Wage in April 2017 looks to have been partly mitigated by staffing and productivity efficiencies, as well as by increasing prices (59% of operators in our confidence and outlook survey were able to pass at least some of the costs onto the consumer). Only six months of the April 2017 increase will be reflected in the current report

Operating Costs - % of Turnover



Source: The ALMR Christie & Co Benchmarking Survey

We hope that you find this report to be informative. Whilst the survey was sent out by The ALMR, our subsequent merger with the BHA meant that the resulting report has been produced primarily for the benefit of UKHospitality's members, and it is our intention that stakeholders use the data contained within to support benchmarking themselves and competitors, as well as to inform policy and assist with strategic business decisions.

Kate Nicholls
Chief Executive Officer
UKHospitality

1. Introduction

An established point of reference for the licensed industry

A unique insight into operating costs, market trends and sector performance

Overview

The UKHospitality Christie & Co Benchmarking Report 2018 is the 12th consecutive edition, and publishes the results of the latest annual benchmarking survey, for the year ending September 2017.

The 12 editions of the survey have been conducted over a period of great change for the industry. A turbulent economy and rapid wider social change mean that an in-depth understanding of both turnover and controllable operating costs are more integral to business planning and success than ever before.

The original survey aimed to provide an understanding of the average costs associated with running a pub in the UK, and the four main objectives behind that survey remain as relevant now as they did in 2007:

- **To support the development of KPIs for commonly-reported operating costs** - understanding costs at an outlet level can allow for internal reviews of cost structure, as well as comparison against the industry as a whole, by market segment and by size of business. This is particularly helpful for smaller operators who cannot readily draw comparisons from within their estate
- **To provide a point of reference for operators seeking to assess performance** - by benchmarking outlet and individual performance, operators can assess the ability of managers and tenants to control and allocate costs, as well as understand the impact this may have on profitability
- **To equip operators with evidence to support business valuations** - rent reviews and rates revaluations are often partly based on assumptions. For example, landlords commonly make a fixed allowance for operating costs. The survey quantifies these costs and allows for differences in trading style to be taken into account
- **To provide UKHospitality with reliable and robust information** - evidence of the long-term and emerging trends within the wider industry can be shared with the Government and other key industry stakeholders for the ultimate benefit of UKHospitality's members

The continuation of the annual Benchmarking Report provides a regular feed on the performance of licensed multiple retailers and the sector as a whole, and it is our intention to continue to undertake the survey annually, and expand it to reflect the wider membership base of UKHospitality, thereby creating a repository of historical data that will allow for the ongoing analysis of emerging trends within the industry.

Protecting the anonymity of respondents is paramount to us

Methodology

In keeping with the approach we have adopted in previous years, this year's survey was devised as a simple series of questions to be completed by operators. The questions contained within the survey covered five main areas of inquiry:

- **Company information** - including company name (not publicly disclosed) and the total number of outlets owned and operated
- **Managed outlet information** - including a matrix of the number of managed outlets operated, together with their tenure and operational or trading style
- **Trading information** - including turnover composition, gross profit margins on food and wet sales, and like-for-like growth for the total managed estate, as well as for the company's leasehold and freehold assets by operational or trading style
- **Operational costs** - including the percentage of outlet turnover accounted for by common operating cost categories, as well as rent and capital expenditure
- **Questionnaire** - on the impact of specific legislative events and confidence in the sector

The survey was distributed via post and e-mail to all operators with ALMR membership, and through the trade press and direct correspondence to include non-members and single site operators.

An illustrative example of the survey is included within Appendix I.

Analysis

For the purposes of our analysis, the term "average" refers to the mean of all company responses. Where appropriate, medians (mid points) and inter-quartile ranges have been included to assess whether the average is being distorted by a small number of outlying responses.

Unless otherwise indicated, the source of all graphs, charts, tables and statistics quoted within this report is The ALMR Christie & Co Benchmarking Survey 2017 (UKHospitality Christie & Co Benchmarking Survey from 2018 onwards).

Information within this report is dated to correspond with the year in which respondents' underlying results were recorded, and not the year in which the benchmarking report was subsequently produced. This differs from the method of presentation adopted in early editions of the report.

Percentages quoted are rounded for presentational purposes, and may not sum exactly to 100%.

Confidentiality

UKHospitality considers the confidentiality of respondent companies' data to be paramount, and individual responses are never disclosed. As such, all results presented within this report are an aggregation of the data contained within multiple survey responses, and all information contained within individual responses remains anonymous.

Confidential data provided by our members is invaluable, and enables accurate analysis of the industry

2. Response Overview

Participation at an outlet level in line with historical levels

Sufficient participation enables reliable analysis

Respondents

Participation was strong across all categories of company size and trading style, and detailed responses were received from 40 companies, slightly down on last years exceptional response of 55 companies, but more in line with the previous year's 43 respondent companies.

Those participating companies provided data covering a total of 3,584 managed outlets. This is significantly above the level typically obtained by independent trade surveys and commentators, and statistical analysis of the data and observed trends is therefore robust and reliable.

Company Size

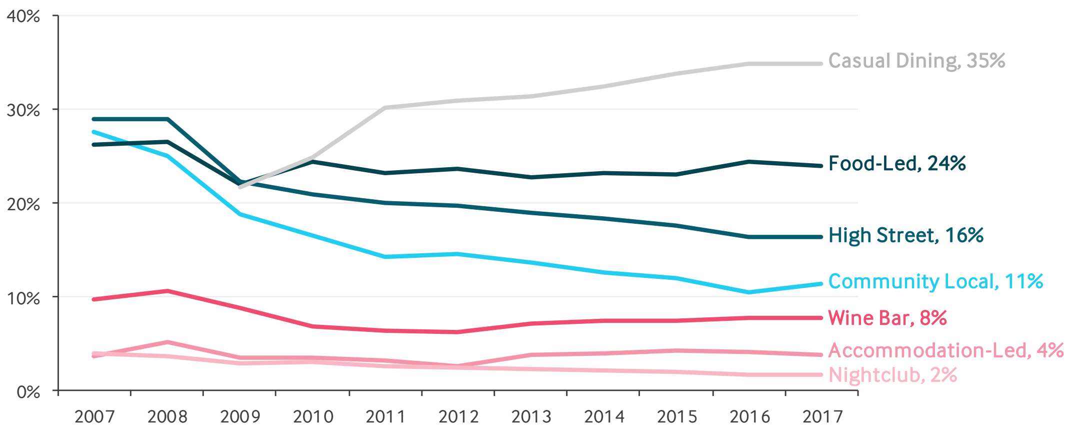
85% of respondent companies were small licensed retailers operating 50 or fewer outlets. 63% of respondents had fewer than 20 outlets, again reflecting the wide participation in the survey. The median respondent company had 16 managed outlets.

Ownership Structure

53% of outlets for which data was received were operated on a leasehold basis, while the remainder were freehold sites. Leasehold outlets include commercial leases, which account for 88% of the leasehold total, and "industry" leases given by a pub company or brewery, which account for 12%. As would be expected, the operating style of these groups was diverse; the majority of Food-Led outlets were freehold sites, whilst Casual Dining, Nightclub and Wine Bar outlets tend to operate on commercial leases. The landscape for Community Local, High Street and Accommodation-Led outlets was mixed.

Amongst those leases which were tied, there was an approximately equal split between those that were tied for both wet products and gaming, and those that were tied for wet products only.

England & Wales Managed Pub and Bar Outlet Universe - % of Total Outlets



Source: CGA Strategy, Christie & Co Research and Analysis

A reliable and representative snapshot of the licensed industry

Operational Style

Operators were asked to classify the assets within their estate into defined market segments – Community Local, Food-Led, Casual Dining, High Street, Accommodation-Led, Nightclub, and Wine Bar. The definitions of these market segments are set out within Appendix I and intentionally mirror classifications typically used by other industry research bodies, for ease of comparability.

Between three and 21 companies provided data for each individual sector, resulting in statistically reliable conclusions to be drawn from its analysis.

Casual Dining outlets accounted for 21% of this year's survey, down from 32% last year, making it the third largest segment to contribute to the survey, behind Food-Led (32%) and Community Local (25%) outlets.

Comparability to the Wider Industry

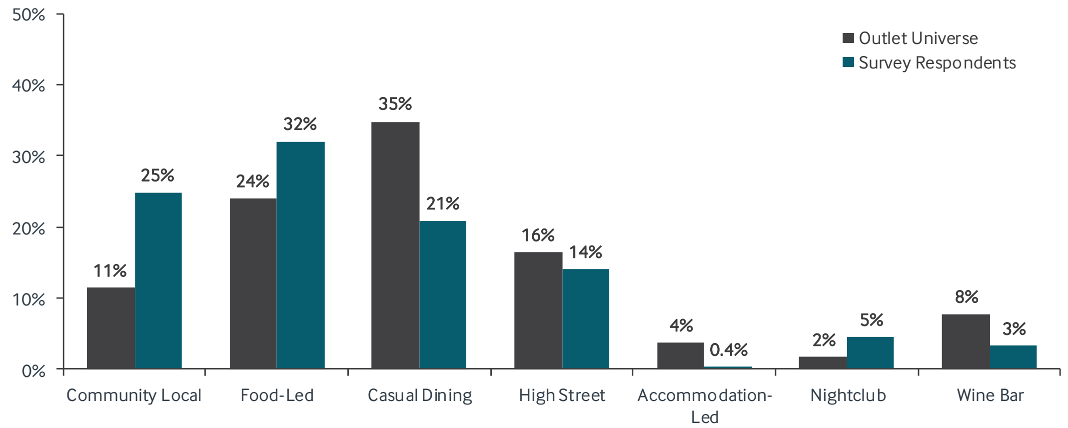
The survey, like the broader UK market, has been reshaped since 2007, as a change in consumer behaviour has led to the rise of food-led operations, with wet-led premises more orientated towards craft beer, gin and other trends.

The graph below compares the distribution of managed outlets surveyed this year with the distribution of the entire managed outlet universe across England and Wales.

As can be seen, the benchmarking survey sample broadly matches that seen across the UK licensed sector as a whole, and as such, the results can be reliably seen as a snapshot of the industry. Where there are minor differences, such as the greater proportion of Community Locals within the survey, or the lower proportion of Casual Dining outlets, this is reflective of the membership profile of respondent parties (i.e. that of the ALMR).

Consumer behaviour has evolved, reshaping the market

Comparison of Survey Respondents to England & Wales Outlet Universe



Source: CGA Strategy, ALMR Christie & Co Benchmarking Survey

3. Revenue Analysis

A diverse industry when analysed at the segmental level

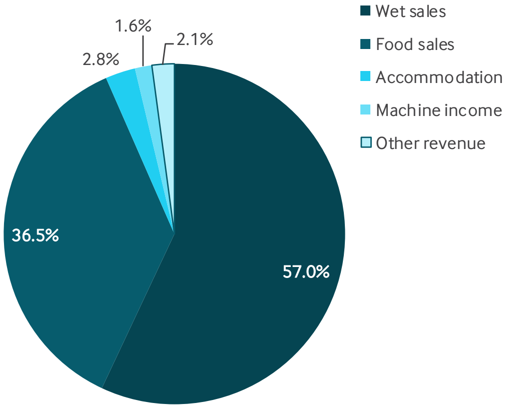
Across all respondents, food sales accounted for 36.5% of turnover, the highest level on record

Revenue Composition

Throughout this report, costs are presented as a percentage of turnover, and therefore understanding the make-up of different sources of income across the industry and by market segment is key to understanding differences in cost base. To this end, respondents were asked to specify the proportion of their total turnover accounted for by different income streams.

Wet sales across the entire survey accounted for 57% of turnover, a significant decrease on last year's 62.6%, and the lowest in the history of the survey. Food sales accounted for 36.5%, the highest on record despite the proportion of Casual Dining outlets across respondents this year decreasing by 9%. Other revenue increased 1.4ppts to 2.1%, an indication of operators looking to alternative revenue streams to attract consumers.

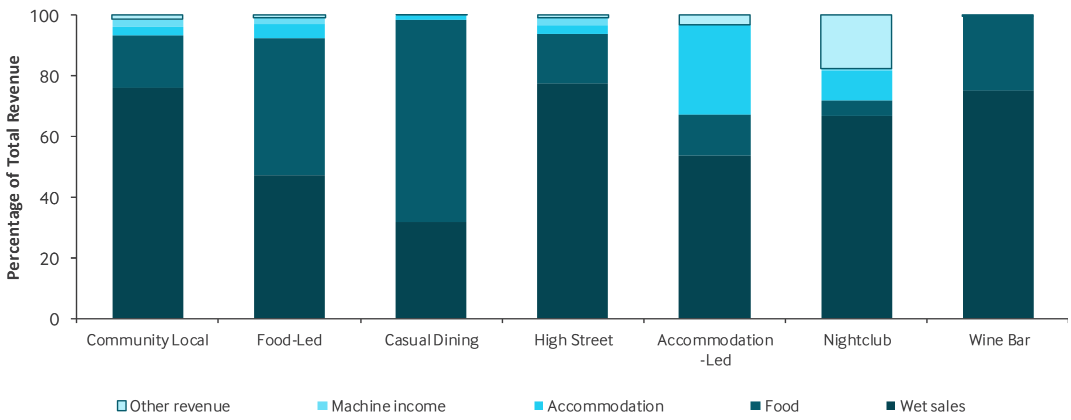
When considered at a segmental level, the proportion of turnover accounted for by wet sales ranged from 77.3% in High Street outlets and 76.2%.



Source: The ALMR Christie & Co Benchmarking Survey

in Community Locals to just 31.7% in Casual Dining. Food sales amounted to 66.7% of revenue for Casual Dining outlets, 45.3% of turnover for Food-Led premises, and yet only 17.3% and 5.1% of revenue for Community Locals and Nightclubs respectively.

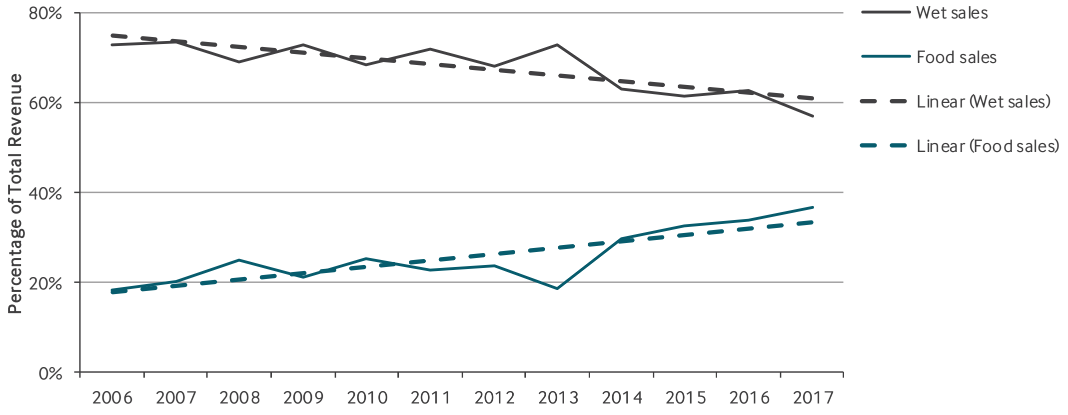
Revenue Composition by Market Segment



Source: The ALMR Christie & Co Benchmarking Survey

Operators focus on growing their food and accommodation sales

Long-Term Trends in Food and Wet Sales



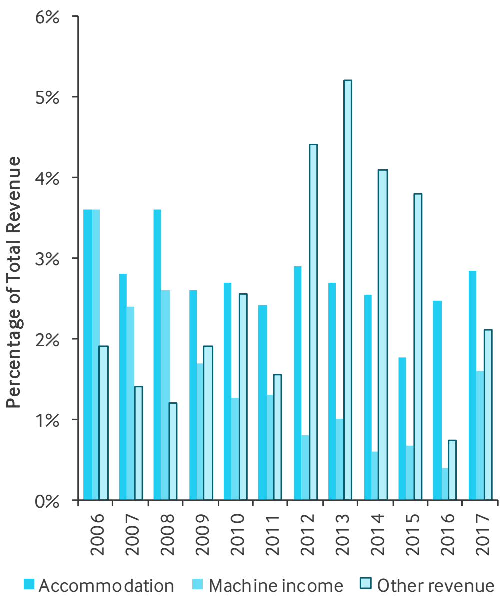
Source: The ALMR Christie & Co Benchmarking Survey

Room revenue up 0.3ppts to 2.8% of total revenue

All other sources of income combined accounted for 6.6% of revenue across the entire survey, an increase of 3ppts year-on-year, which is partly attributable to the change in respondent profile versus prior year, as well as evidence that operators are having to offer more than just food and drinks to entice customers. Income profile is generally dictated by market segment and further analysis of trends at a segmental level is included within section 11 of this report.

Accommodation increased marginally to 2.8% of revenue, which supports the continued trend for buying or developing coaching inns and pubs with letting rooms. Machine income increased 1.2ppts since last year's report to 1.6% of revenue in the current year, reflective of a higher proportion of Community Local pubs, which are typically more heavily reliant on this high-margin income stream.

Long-Term Trends in Other Revenue



Source: The ALMR Christie & Co Benchmarking Survey

3. Revenue Analysis (continued)

Tougher trading conditions hit performance

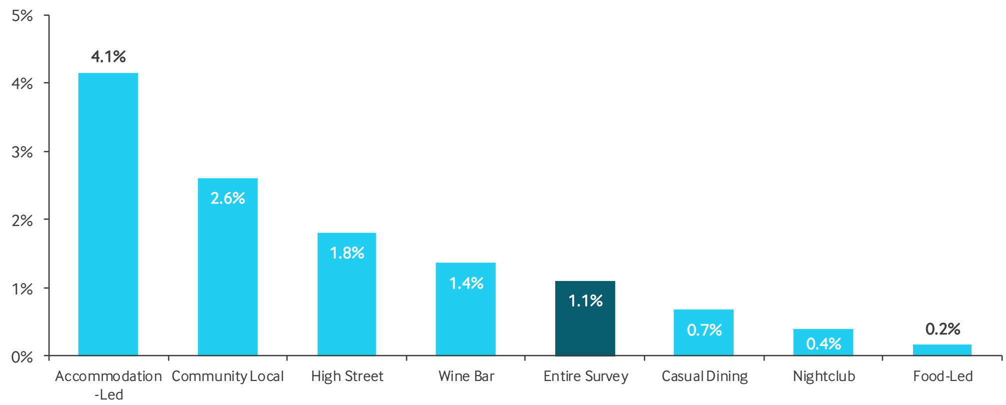
All segments in nominal growth for second year running; but inflation rising faster than many segments

Other revenue, which includes tickets and entrance charges are particularly important for Nightclub premises, accounting for 17% of turnover on average for this market segment, which is up 3ppts on the previous year. In addition to this, the segment is enjoying its second year of growth; a sign that the late night sector continues to evolve, as operators become less reliant on entrance fees or unable to sustain door charges, yet are still able to drive other revenue through innovative means, such as daytime venue hire.

Annual Like-for-Like Growth

The survey asked respondents for percentage changes in like-for-like turnover. On average, a 1.1% rise in turnover was reported in the year, consistent with last year's report and steadying the gradual slow down in growth rates seen over the past four years. By comparison, the Office for National Statistics reported that the Retail Price Index (RPI) measure of inflation grew by 3.9% over the same period, indicating that the sector may have experienced a significant contraction in real terms, and across nearly all segments.

Like-for-Like Growth by Market Segment



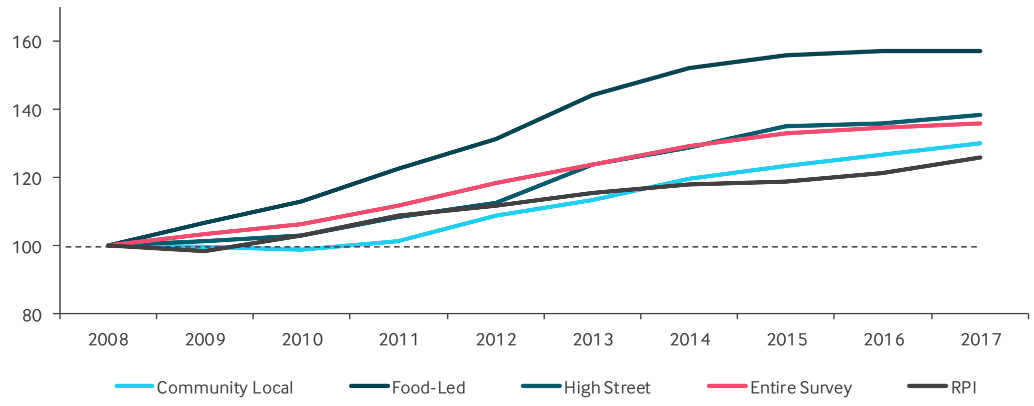
Source: The ALMR Christie & Co Benchmarking Survey

This year Accommodation-Led outlets continued to perform, with outlets recording the highest like-for-like growth across all market segments, at 4.1% (5.1% in 2016). This trend has become increasingly self-reinforcing, with many operators looking to explore this higher margin income stream by developing unutilised space.

Although the Food-Led and Nightclub segments fell to the bottom of the class in terms of like-for-like performance, all segments saw growth in nominal terms for the second consecutive year of the report.

Top line performance at Food-Led outlets flat due to oversupply

Like-for-Like Growth by Market Segment – Rebased from 2008

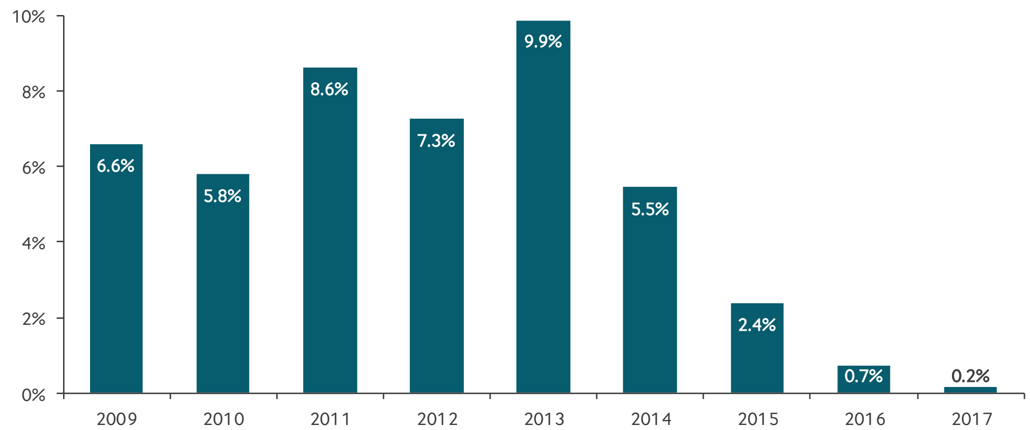


Source: The ALMR Christie & Co Benchmarking Survey

The meteoric rise in Food-Led businesses in the seven years to 2015 is most certainly at an end

Food-Led outlets reported subdued growth in the year with like-for-like sales growth slowing for the fourth consecutive year, as oversupply in the market on the back of aggressive restaurant expansion has impacted performance. Whilst food remains an essential part of many successful operations, there is clearly subdued growth within the Food-Led segment, and the resurgent Community Local segment is now being targeted by operators and investors as more likely to deliver better returns. The challenge for operators is to deliver stronger growth, to ensure profits are not eroded by high inflation.

Like-for-Like Growth of Food-Led Outlets – Year Ending September 2009-17



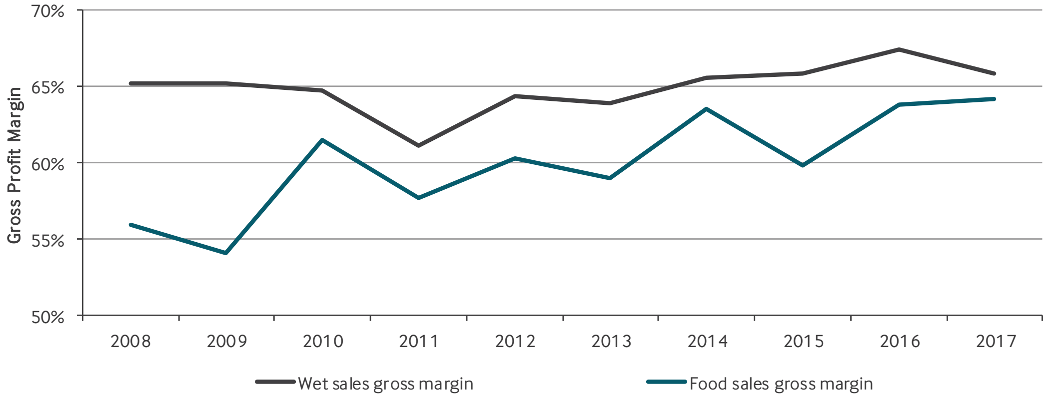
Source: The ALMR Christie & Co Benchmarking Survey

4. Margin Analysis

Margins hold steady, despite harsh trading environment

Gross profit margins on wet sales remain 1.7ppts higher than on food sales

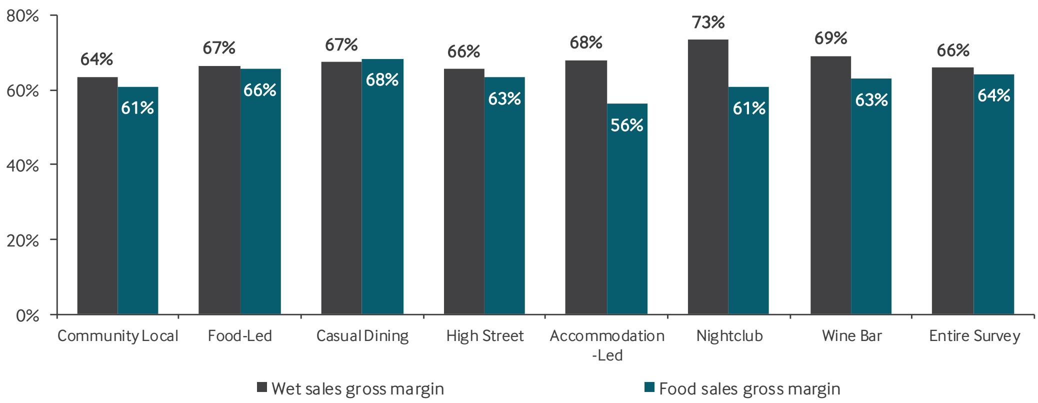
Gross Profit Margins – Food and Wet Sales



Source: The ALMR Christie & Co Benchmarking Survey

Gross profit margins on food sales improved slightly to 64.2%, a 0.4ppts increase from the previous high of 63.8% in the 2017 report. At a segmental level, the picture is very diverse. Within the Casual Dining segment, margins on both wet and food sales have contracted for the second year in a row, falling by 3.4ppts and 0.9ppts respectively, as a competitive trading environment on the back of oversupply and a full year of post-referendum currency devaluation were felt. Conversely, Community Locals continue to improve dry margins, as scale efficiencies from increased food sales, now making up 17.3% of revenue (16.2% in 2016) take effect. Subdued food margins in Accommodation-Led outlets are likely a result of bundling breakfast within room revenue as opposed to food sales.

Gross Profit Margins by Market Segment



Source: The ALMR Christie & Co Benchmarking Survey

5. Operating Cost Analysis

Operating costs grow faster than turnover for second year in a row

In order to collate comparable cost data on licensed outlets, we asked companies to quantify the level of certain common operating costs by reference to percentage of net turnover. The common operating cost categories used were as follows:

- **Payroll costs** - gross payroll costs including staff wages, PAYE, NICs and manager's salary
- **Entertainment costs** - Sky and/or other subscription packages and charges, entertainment licenses and fees to PRS and PPL for background music, and live entertainment and security costs
- **Utility costs** - electricity, gas and other fuels, water and sewage and waste disposal
- **Operational costs** - including cleaning, laundry and glassware
- **Premises costs** - including rates, insurance and repairs and maintenance but excluding rent and capital expenditure
- **Other ongoing costs** - all other costs that do not fit into the above categories

Rent as a proportion of turnover for leasehold outlets and **capital expenditure** were requested separately to the above.

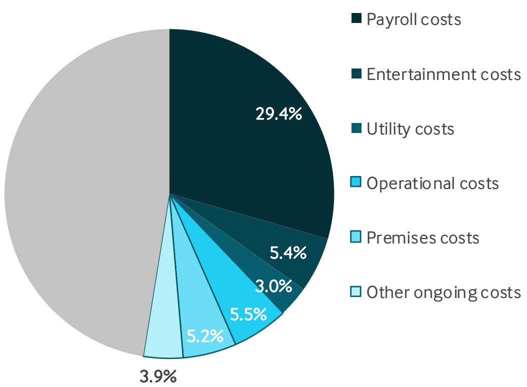
All information was provided on a rolling 12-month basis.

Further details on the costs apportioned to each cost centre are set out in the survey questionnaire in Appendix I.

Total Operating Costs

Set out below is the aggregated average figures for each of the operating cost categories as a percentage of turnover. Costs have been grouped together for ease of reference. These figures are an average across all outlets participating in the survey and therefore provide an indicative benchmark across the wider licensed sector. Granular analysis for the different trading styles is included within section 11 of this report.

Operating Costs - % of Turnover



Source: The ALMR Christie & Co Benchmarking Survey

Survey responses suggest that the average operating costs across all market segments amounted to 52.5% of turnover, before rent is taken into account, a 1ppt increase on the previous year (51.5%). Much of the increase was due to the rising wage costs on the back of a rise in National Living Wage as well as implementation of the Apprenticeship Levy and a tranche of Pension Auto Enrolment. Further increases are expected in the coming year as these costs annualise.

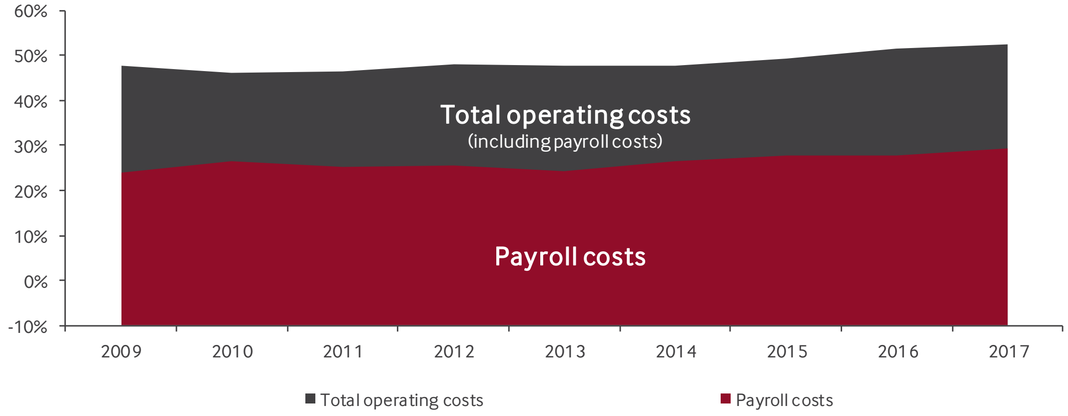
4.8ppts increase in operating costs since 2014

5. Operating Cost Analysis (continued)

Payroll costs rise further under National Living Wage

Payroll costs have risen from 17% to over 29% since the introduction of the National Minimum Wage Act in 1998

Payroll and Total Operating Costs – Percentage of Revenue



Source: The ALMR Christie & Co Benchmarking Survey

Payroll Costs

Typical payroll costs now account for 29.4% of turnover, 1.5ppts more than in the previous year. Though unlikely to have been affected directly by National Living Wage, the average manager's salary increased by 0.4ppts to 7.4% of turnover, indicating that pay differentials are being partly maintained.

Payroll costs have risen significantly over the longer term, from 17% of turnover in 1999 when The ALMR first carried out its wage survey as part of evidence submitted to the Low Pay Commission. The current level is the highest reported in the history of the survey, reflecting the impact of National Living Wage, Apprenticeship Levy and Pension Auto Enrolment.

The National Living Wage

The National Living Wage (NLW) became effective in April 2016, replacing the National Minimum Wage (NMW) for over 25s. It was initially set at £7.20 per hour, an increase of 7.5% on the previous National Minimum Wage. NLW increased to £7.50 per hour in April 2017, and a further increase to £7.83 in April 2018 will likely cause further cost increases in next year's report. The rate is currently predicted to increase above the rate of inflation to £8.57 per hour by April 2020.

Given the relatively low wage rates for some roles within the licensed sector, many staff will have seen their wages increase each April, either as a result of compliance with the legislation, or in order to retain existing pay differentials. As such, profitability across all segments apart from Wine Bars and Nightclubs has been impacted as operators have found it difficult to successfully pass the additional costs of NLW increases onto consumers.

Community Local outlets are expected to be less affected than other segments as staffing levels are generally lower due to management having a more hands-on role and undertaking a greater proportion of labour themselves. However, we have seen a significant increase in payroll costs in this segment, indicating that managers are now themselves being captured by the rising NLW thresholds.

Business Rates revaluation and other pressures to increase overheads

Entertainment Costs

Entertainment costs have now been rising for two years, and now amount to 5.4% of turnover. This suggests that operators are having to work harder to drive footfall and business. The cost of TV packages did rise marginally in the period, potentially due to being partly linked to business rates.

Utility Costs

Average utility costs across all survey respondents amounted to 3.0% of turnover in the year to September 2017, an increase on the historically-low levels seen in the previous year, where lower wholesale energy prices and tougher negotiating were seen. Most utility providers offer the opportunity to fix prices, as a result the price increases seen in the first half of 2017 and 2018 will take some time to filter through into P&Ls fully.

Operational Costs

Average operational costs across the survey amounted to 5.5% of turnover, down on last year's 6.6%, although currently still the biggest category of overhead after payroll. These costs are expected to grow further in 2018 as labour cost inflation for providers of operational services, such as cleaning costs where these are outsourced, is passed on.

Premises Costs

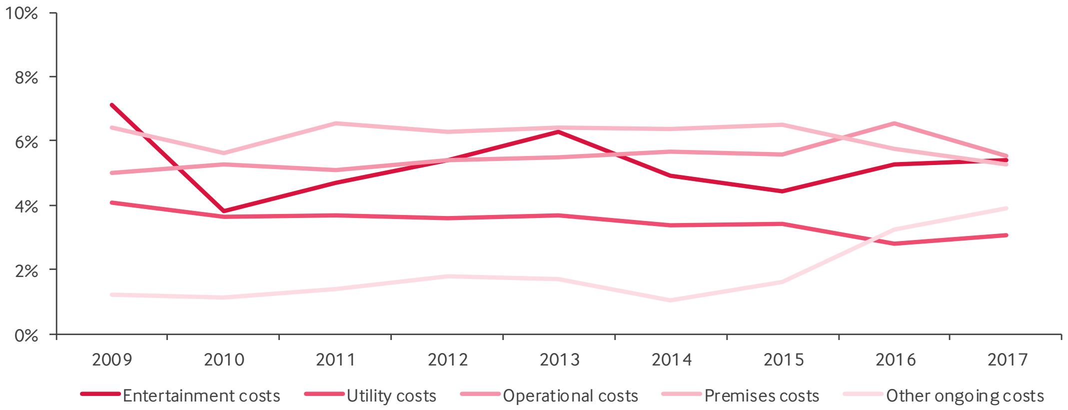
Premises costs, which exclude rent, are at the lowest level in the history of the report, at 5.2%. The fall in premises costs is likely driven partly by lower repair spend in Casual Dining, Wine Bar and Nightclub outlets, as well as a number of outlets falling within the small business rates relief threshold, and the impact of temporary reliefs for publicans. We are now at the low point of the investment cycle, and with business rates materially increased in April 2017, this cost is expected to grow significantly next year.

Other Ongoing Costs

Other ongoing costs increased yet again. These costs now make up 3.9% of turnover, a new high, and significantly above historical levels of 1%-2%. The survey does not provide sufficient detail for further granular analysis of these costs.

Overheads excluding payroll have decreased to 23.1% of turnover

Operating Costs (excl. Payroll Costs) – Percentage of Revenue



Source: The ALMR Christie & Co Benchmarking Survey

5. Operating Cost Analysis (continued)

Three segments reporting operating costs in excess of 50%

Entertainment expenditure in Nightclubs being used to drive revenues

Operating Costs by Market Segment

As can be seen from the breakdown of operating costs in the graph below, each of the market segments exhibits a unique cost profile.

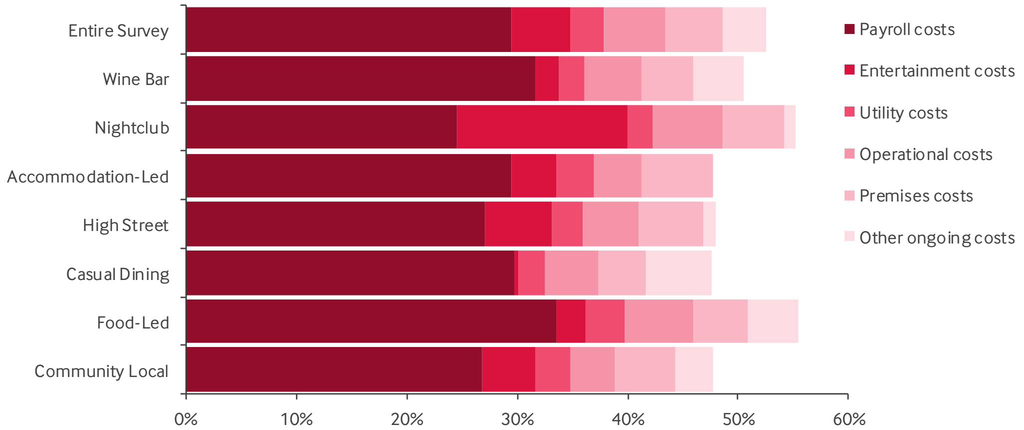
Excluding Casual Dining, total operating costs were lowest in Community Local outlets, aided by lower payroll costs, and Accommodation-Led outlets, which saw the greatest fall in total costs (likely a result of statistical issues arising from the limited participants in this segment). Payroll costs have increased across all segments, as operators have limited room to counteract the increase in NLW, introduction of the Apprenticeship Levy or the latest tranche of Pension Auto-Enrolment through planned efficiencies and staff reduction.

Three segments have operating costs in excess of 50%, being: Food-Led; Wine Bars (both of which have high payroll costs); and Nightclubs, where entertainment is a significant driver, with its own additional cost base. At 15.4% of revenue within this segment, operators are clearly having to work hard to drive trade.

Premises costs, which exclude rent and capital expenditure but include rates and repairs, do not vary markedly between segments as a percentage of turnover, averaging 5.2% across the entire survey, down 0.6ppts on last year. Premises costs are expected to increase in 2018 as the latest business rates revaluation fully annualises. Increased repairs may also be required as a result of significantly lower capital expenditure seen in this year's results.

Our predictions for overall operating costs in the next survey are for more segments to breach the 50% threshold, leading to an overall increase in reported operating costs. The observed cost profiles of the various market segments are discussed in further detail throughout this report.

Operating Costs by Market Segment – Percentage of Revenue



Source: The ALMR Christie & Co Benchmarking Survey

For the average leasehold business, total overheads now exceed 60%

Rent Analysis

The survey asked respondents to express rent as a proportion of turnover for their leasehold estate. On average, the level of rent across the entire survey was equivalent to 8.8%, up 0.3ppts from the previous year.

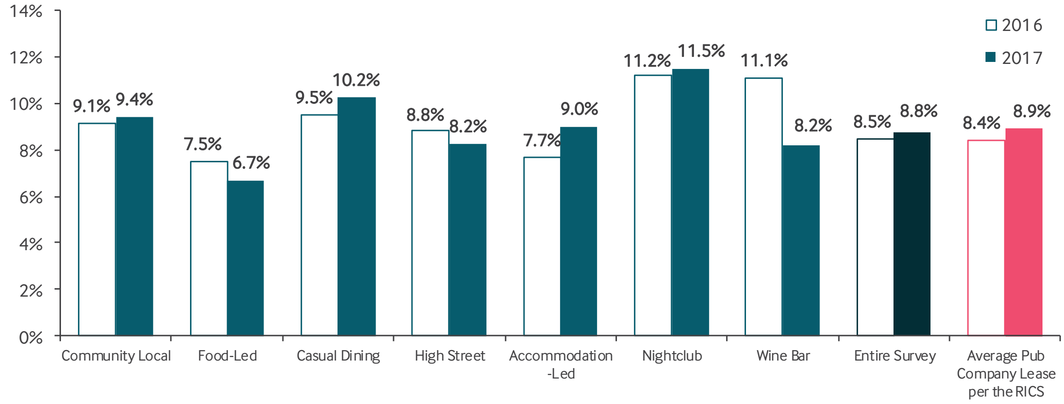
Rent, when expressed as a percentage of turnover, is a reasonable indicator as to the affordability of a premise. For tied premises, the level of rent that can be considered sustainable will depend heavily on the terms of the tie, with the RICS reporting that average rent for pub company leases was 8.9% (Q3 2017), whereas even for a fully-fitted, free-of-tie premises, rental levels above 15% are on the verge of being unsustainable in certain sectors and geographies.

The average size of leasehold estates amongst respondents and between categories remains incredibly varied. This can make direct comparison to the broader market or between segments challenging, as larger operators may be able to use their enhanced covenant strength to support negotiating preferential rents, the increased security also often contributing, potentially materially, to the investment value of the underlying freehold.

Casual Dining, Wine Bar and High Street segments are all generally located on or near-to the high street. Wine Bars and High Street outlets are showing decreased levels of rent as a percentage of revenue on the previous year, indicating that we passed the peak of the market during 2017. However, despite this, the Casual Dining segment continued to see rental increases, suggesting that landlords were still creating a highly competitive bidding environment over their restaurant units. The challenges faced by the Casual Dining sector came to a head during early 2018, as evidenced by a number of large and very public CVAs undergone by high street brands. During this process, we saw rental reductions of up to 40% within the market, and as a result, we expect this to feed through into the results of the 2018 survey in the form of reduced Casual Dining rents.

Average rent of 8.8% across the entire survey

Rent Levels by Market Segment – Percentage of Revenue - 2016-2017



Source: The ALMR Christie & Co Benchmarking Survey, the RICS

5. Operating Cost Analysis (continued)

We passed the peak of the investment cycle in 2017

All segments reported capital expenditure within 2.7ppts of the survey average of 3.5%

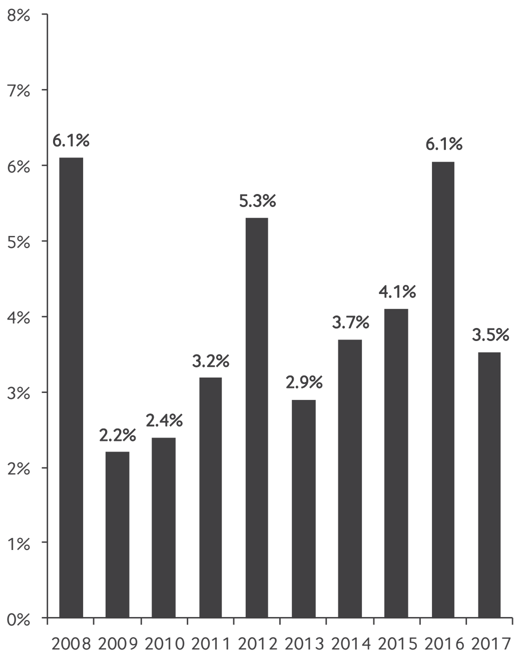
Capital Expenditure Analysis

Capital expenditure excludes repair costs, which are included within the premises costs line.

The average capital expenditure across the entire survey was 3.5%, with all segments recording expenditure within 2.7ppts of this. The adjacent graph indicates the cyclical nature of capital investment over the past 10 years, with it appearing that we are currently at the low point in the investment cycle. However capital expenditure remains above the recessionary low seen in 2009, as debt and equity are both relatively readily available to fund improvement projects capable of generating returns.

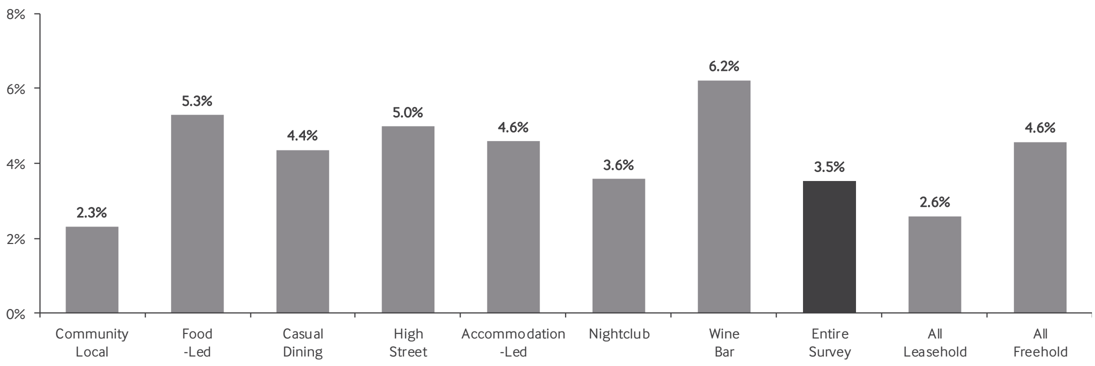
Freehold capital expenditure is once again ahead of leasehold, with freeholders having more flexibility and greater incentive to invest (as they retain the capital uplift), leading to greater investment, whilst the primarily leasehold Casual Dining boom fizzled out during 2017.

Capital Expenditure - % of Turnover - 2008-2017



Source: The ALMR Christie & Co Benchmarking Survey

Capital Expenditure by Market Segment and Tenure – Year to September 2017



Source: The ALMR Christie & Co Benchmarking Survey

6. Analysis by Ownership Model

Freehold ownership remains an aspiration for many operators

Tenure

53% of the managed properties operated by survey respondents are leasehold assets, of which 88% are commercial leases, the remaining 12% being tied industry leases. This is below the c.30% tied level seen across the wider UK, which is reflective of The ALMR's membership having been predominantly multiple operators, whereas the majority of tied pub tenants in the UK operate a single premises.

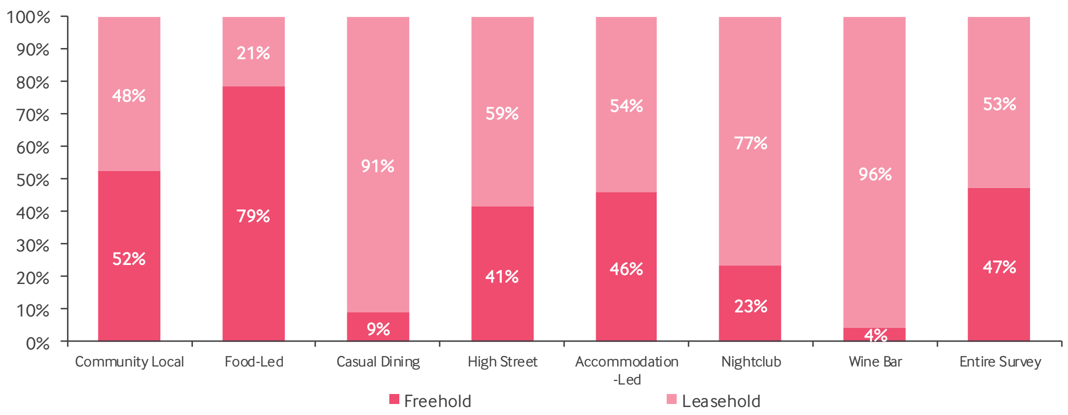
At a segmental level, Wine Bars and Casual Dining have the highest proportion of leasehold premises at 96% and 91% respectively, followed by Nightclubs at 77%. Premises in these segments tend to be located in high-footfall town and city centres or out-of-town retail and leisure parks, where it is common for the freehold ownership of the property to be held by an institutional investor distinctly separate from the leasehold operational interest.

Food-Led businesses recorded the highest level of freehold ownership, at 79%, followed by Community Locals, at 52%. Of the leasehold assets across these two segments, 28% of leases are industry leases where a tie is in place. Underlying this, 161 of 424 Community Local leases were tied, along with 26 of 246 Food-Led leases.

It remains the long-term aspiration of many public house operators to acquire the freehold of their property, and use profits to make repayments on their mortgage as opposed to paying rent to a pub company or commercial landlord. Furthermore, where operators do own the freehold, it allows them full discretion on use of the building (subject to planning consent and licensing restrictions) without having to obtain permission from the landlord for alterations and potentially change of use. However, the cost of acquiring the freehold can be prohibitive, particularly in town and city centres where capital values are generally higher, and we anticipate the majority of freehold ownership to be in community, village and rural locations. Most lenders require a deposit of at least 30%, which can price many operators out of freehold ownership.

53% of managed properties within the survey are leasehold assets

Tenure Split by Market Segment



Source: The ALMR Christie & Co Benchmarking Survey

6. Analysis by Ownership Model (continued)

Commercial leases show improved margins at the cost of higher rent

Wet margins are 9ppts higher for commercial leases than tied leases

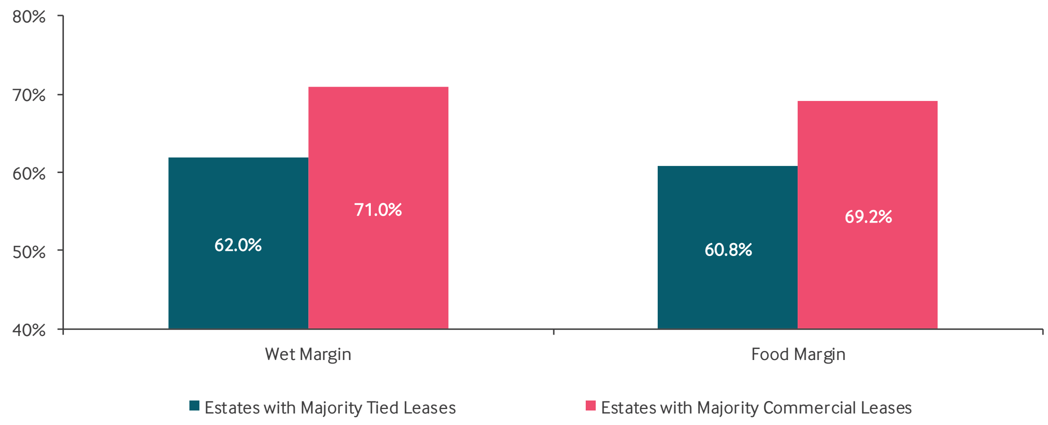
Tied Leases and Trade Split

We analysed gross profit margins by tenure across all survey respondents, looking in particular for differences in gross profit margin between those whose assets were held primarily via industry leases (i.e. tied tenants) and those held primarily on commercial (i.e. free-of-tie) leases. For the purposes of our analysis, we have only considered respondents whose leasehold estates contain equal to or greater than 75% of a single lease type (i.e. either industry or commercial).

As those with knowledge of the tied sector might anticipate, gross profit margins on wet sales for estates with primarily commercial leases were higher than their tied counterparts, at 71% and 62% respectively. Landlords (i.e. the freeholder) of tied leases generate wholesale profit from the sale of tied stock to their tenant, whilst tied tenants can often expect to pay less rent than they would under a free-of-tie lease. The survey results confirm this when the data is analysed at a segmental level, and rent costs are indeed higher for commercial leases within certain segments, such as Accommodation-Led and Wine Bars, where free-of-tie rents are 3.3ppts higher than the tied rents. However, this is distorted within the Community Local segment by the average free-of-tie estate being 54 premises in size, three times that of the average tied estate, which is 18 premises in size, the resulting increase in covenant strength more than offsetting this effect.

The different terms offered to tenants on a tied and free-of-tie basis have come under increasing scrutiny since the Pubs Code became effective in July 2016, which permits tenants of pub companies with more than 500 tied pubs to request a Market Rent Only option when certain trigger events occur. However, it is important to note that there can be many additional benefits of being a tied tenant, such as lower costs of entry and marketing support. The lease will vary between tenants including different levels of tie (ranging from being tied only for beer, to all alcoholic beverages and minerals), reflecting the business model, the financial position of the tenant in question, and careful consideration of the outlet's unique characteristics and trading profile.

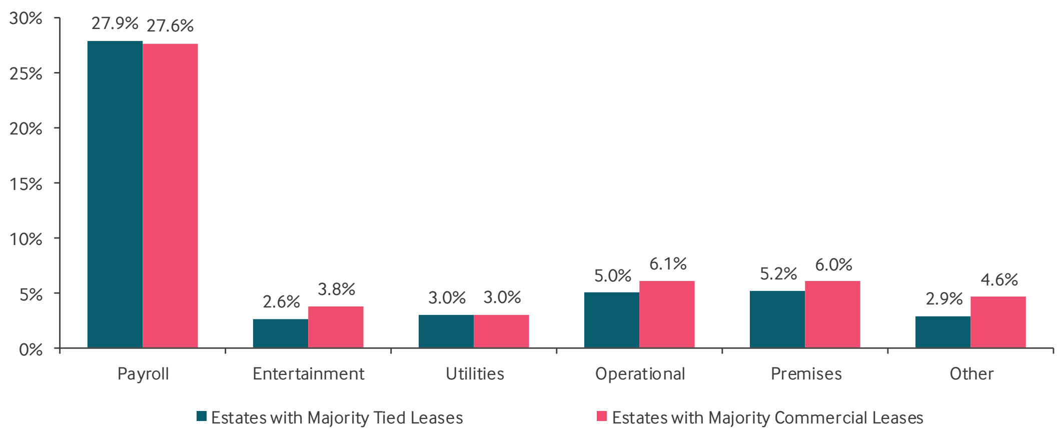
Gross Profit Margins – Tied Leases vs Commercial Leases



Source: The ALMR Christie & Co Benchmarking Survey

Cost profiles reflect the variance in segmental composition

Operating Costs – Tied Leases vs Commercial Leases

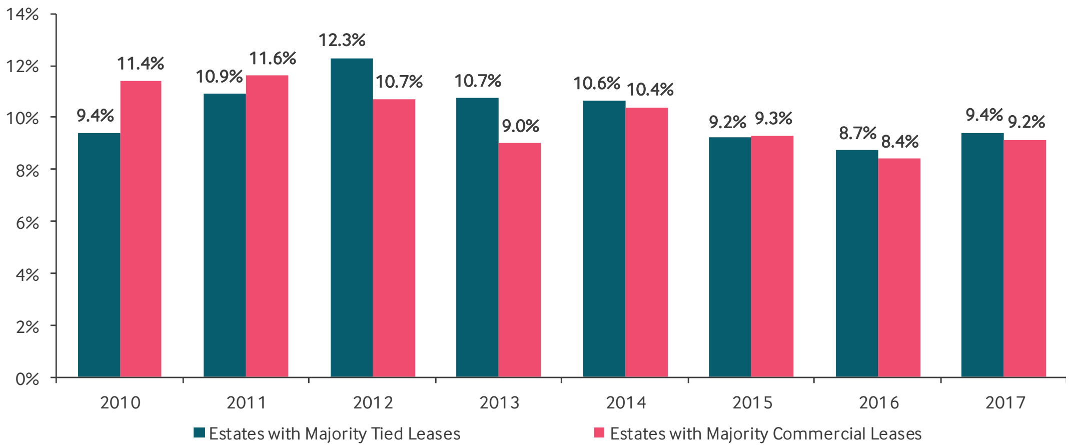


Source: The ALMR Christie & Co Benchmarking Survey

Operating costs after rent were 60.3% for estates with predominantly commercial leases

Total operating cost (before rent) was 46.6% for those leasehold estates with predominantly tied premises, which is slightly lower than the 51.2% for those majority free-of-tie estates. This is in line with our experience of licensed premises, where the difference between industry and commercial leases tends to be more pronounced in gross margins on wet and machine income, and rent, than operating costs. We consider that much of this variance is due to inherent differences between segments which are pre-disposed to one lease type, as outside of premises costs, there is little commercial driver for the difference in overheads. Once rent is included, the total costs for industry and commercial leases amount to 56.0% and 60.3% respectively, which is reflective of broadly equivalent rents.

Rent – Tied Leases vs Commercial Leases



Source: The ALMR Christie & Co Benchmarking Survey

7. The Pubs Code

Disruption within the market, but very few MRO leases awarded

Appetite for MRO remains high but a number of barriers remain

The Pubs Code

At implementation in July 2016, the Pubs Code affected those pub-owning businesses (POBs) with at least 500 tied pubs in the UK, and introduced the Market Rent Only (MRO) option, allowing tied tenants to go free-of-tie at certain trigger points. In theory, going MRO could increase wet margins, and ultimately lead to higher profitability for the tenant at the expense of a higher free-of-tie rent.

Has the Pubs Code achieved its objectives?

At the time of writing over two years have now passed since the introduction of the Pubs Code. Six major POBs are currently affected by the Code with Hawthorne Leisure/New River Retail remaining below the 500 tied pub threshold, and are thus yet to be captured by the legislation.

From a tenant point of view, appetite for transitioning into MRO has remained high, however a number of barriers remain. The MRO process has restrictive notice and response times associated with the legislation, and many tenants are unintentionally allowing their right to request an MRO option to lapse (or be forced to act without receiving appropriate professional advice). To put this in perspective, of the 668 responses to MRO notices issued since the Code's introduction in July 2016 up until July 2018, only 53 new MRO tenancies had actually been agreed (on a new agreement).

In theory, for those tenants that do comply with the various deadlines, the free-of-tie rent offered to tenants should reflect that of free-of-tie market rents for comparable public houses. However, to disincentivise tenants from breaking the tie, there are a number of significant upfront costs that POBs can impose on transitioning to a new commercial lease (as opposed to merely amending the terms of the existing tied lease through a deed of variation – which has become a contentious issue in itself). Typically, this can include dilapidations, rental deposits, and quarterly rent in advance. The pubs that should benefit the most from exercising an MRO option are those that are trading well and are able to drive large wet volumes. However, it is also these sites that the affected POBs are more frequently taking back to operate themselves under managed or franchised models. If this is the case, tenants lose their ability to renew the lease altogether.

Stocking requirements have also been highly contentious, mandating that even under a free-of-tie lease, a percentage of fridge space and draught lines are taken up with a landlord's products, albeit purchased from a supplier of the tenant's choosing. The very existence of stocking requirements in MRO-compliant leases has already been challenged, forcing clarification that the inclusion of a stocking requirement does not on its own indicate that a lease is tied. Another current battleground is over the publication of arbitration decisions to help clarify disputed areas of the code, and it appears that the Pubs Code Adjudicator (PCA) has agreed on principles for the publication of Pubs Code arbitration decisions outlined by the British Beer and Pub Association (BBPA). Whilst it is not exactly clear what these principles are, the outcome will provide greater transparency for all parties, whilst respecting the commercially sensitive information of POBs.

In Summary

The Pubs Code was in itself a compromise between the objectives of government and the needs of many different stakeholder groups, and yet many are suggesting it has failed to meet its objectives, with some resorting to demonstrations in Parliament square, calling for urgent review. This remains a possibility during 2019.

8. Cost Pressures 2018 and Beyond

The perfect storm continues, with costs predicted to increase further

The Perfect Storm

There are a number of cost pressures which have affected operators in recent times, not all of which were known about far enough in advance to effectively prepare for. Such increases are being felt in direct payroll costs through increases in National Living Wage, Pensions Auto-Enrolment and the introduction of the Apprenticeship Levy, as well as property costs experiencing material changes on the back of the business rates revaluation, and operational costs increasing on the back of rising utility prices. The impact of some of these cost increases started to be felt in last year's report, whilst others have been observed in this year's report, with total overheads increasing yet again.

National Living Wage

A National Living Wage of £7.20 an hour came into effect in the UK in April 2016, replacing the National Minimum Wage for workers aged 25 and over. In April 2017, the NLW increased to £7.50 an hour, with further increases expected through to 2020, by which point NLW should reach 60% of median earnings, currently expected to be c.£8.57. The second wave of NLW increases took effect six months in to the survey period, and we have seen the impact of this as total payroll costs in the survey continue to increase. As consumers become increasingly price-sensitive, mitigating wage cost inflation through price increases become more challenging, and so each further increase in NLW is likely to continue to filter through into payroll costs and reduced profitability in future reports.

Business Rates Revaluation

The latest business rates revaluation came into force in April 2017, resulting in a number of winners as well as losers. However, due to the mechanics of this tax, businesses whose Rateable Values are based on turnover, such as licensed premises, were hit the hardest. In response to the impact on these businesses, Chancellor Phillip Hammond extended reliefs available to licensed operators until March 2019, and there are plans to reduce the period between revaluations to three years. The impact of shorter revaluation periods should mean that changes in rent will be reflected sooner, and thus operators should not be hit with as sharp an increase in Rateable Value each review. However, unless there is a freeze on rates (the future of which is determined by the Consumer Price Index), or a total overhaul of the entire business rates system, licensed operators will continue to be penalised.

Apprenticeship Levy

Increasing both the quantity and quality of apprenticeships is central to the government's strategy for upskilling the UK workforce, and they have committed to a target of 3 million additional apprenticeships commencing between 2017 and 2020, funded through the introduction of an Apprenticeship Levy. Only companies with wage bills in excess of £3m (1.8% of employers) are being asked to contribute, at a cost of a 0.5% levy on the total wage bill in excess of that amount.

Utility Costs

Wholesale energy prices make up around 50% of the average annual utility bill, and are therefore the predominant factor in determining retail prices; where wholesale costs rise, these are invariably passed on to end consumers. Prices have been relatively volatile in the past few years, with significant increases in the first half of the year in both 2017 and 2018.

National Living Wage predicted to hit £8.57 by April 2020

9. UK Membership of the EU

The period of Brexit-induced uncertainty continues

Unless an extension is agreed, the UK will leave the EU on 29 March 2019

Referendum and Brexit

It has been over two years since the UK referendum on membership of the European Union took place and we are ultimately no closer to understanding the systems that will be in place after the UK leaves the EU. The two year countdown that began when Article 50 was triggered is due to expire on 29 March 2019, and yet negotiations between Britain and the 27 remaining EU states (each with their own views and priorities) are continuing.

What's happening now?

In March 2018, decisive steps were made in negotiations, including a 21-month transitional period from the date of Brexit in March 2019, and an agreement to move Brexit talks in to the final phase. The UK and EU have provisionally agreed on issues such as: how to settle financial obligations owed to the EU by the UK; the desire to avoid a "hard border" in Northern Ireland; and citizenship rights for both UK and EU citizens. The Chequers Plan, which details a proposed economic partnership with the EU was set out by Theresa May, and has come under some criticism, not only from the EU but also from within both her own party and opposition parties.

Further to this, there is speculation over whether the UK might hold a second referendum on leaving the EU in the event of no deal being struck with the EU, or if parliament does not approve of the deal made.

With the due date for withdrawal from the EU looming, both sides need to reach a deal in time. Until then, the uncertainty around the outcome of Brexit and what it means for the future of the UK, remains. For confidence to grow, the sector needs an outcome that delivers frictionless, minimum tariff trade, and that sustains a competitive domestic market. This would allow the hospitality sector to take advantage of any opportunities Brexit offers, not least in terms of exports and foreign investment.

Impact on the Licensed Sector

The uncertainty around Brexit is perhaps the most frustrating aspect for operators and investors preparing for an outcome that is largely unknown. In light of this, businesses should be thinking of how they would manage a change in staff and supplier landscape, both of which have a significant impact on the licensed sector.

The Pound is a proxy for the confidence that investors have in the UK, and remains subdued behind its pre-referendum levels. This has had a number of knock-on effects, including the UK becoming less attractive to those EU migrant workers. This does not bode well for a sector where 40% of workers are from the EU, according to statistics released in June 2018 by Fourth Analytics (which are admittedly skewed by a high representation of immigrant workers within Quick Service Restaurants). The Office for National Statistics estimated that 138,000 EU nationals emigrated in the year ending March 2018, although the net figure remains an influx of around 100,000 coming into the UK. The high rate of EU nationals leaving adds to the already significant difficulties operators already face in attracting and retaining staff, ultimately leading to higher costs, or an inability to capitalise on growth opportunities.

The cost of imported wines, beers, spirits and food all increased in 2016, leading to a combination of price rises and tightening margins that operators have had to endure since. The effects don't stop within our sector, though; if wider inflation outstrips wages, consumer confidence will be hit, with potential knock-on effects such as coincidental pressures to increase the National Living Wage, which would bring yet further cost pressures back to operators. In the longer term, the issue of what tariffs apply to imported goods - particularly how quotas are split - will be the key determinant of prices. The devil, as they say, will be in the negotiated detail.

The story is not entirely negative however – some opportunities arose from a weaker Pound. Firstly, an increase in inbound tourism to the UK, coupled with an increase in staycations by UK residents deterred by the increased cost of overseas travel, benefitted both accommodation providers such as hotels and pubs with letting rooms, and the economy as a whole, as more money was either brought into or retained within the UK.

The result of Brexit negotiations could have a significant effect on the licensed sector and the UK economy as a whole and may provide opportunities for legislative change. Accordingly, it is apparent that this topic will continue to be of paramount concern to operators, not just until March 2019, but potentially for the next decade.

Several opportunities arose from the continuation of the Pound's weaker value

10. Confidence and Outlook Survey

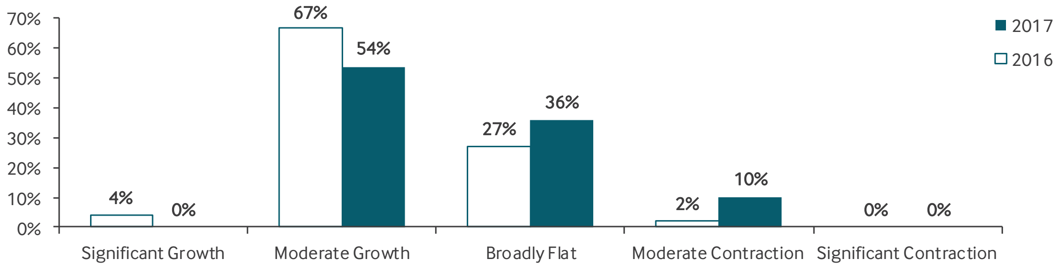
Hiring and firing correlates to confidence in profitability, not revenue

Confidence in growth falls from 71% to 54% during the year

Confidence Survey 2018

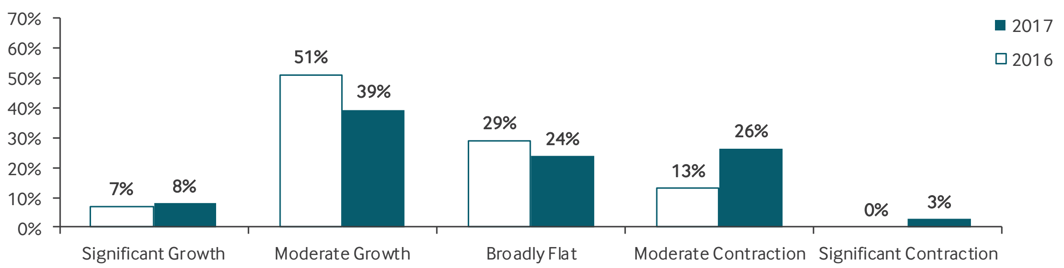
The Confidence Survey was introduced in the 2017 report for the first time, and the 2018 report has included the results of a series of straightforward multiple choice questions, once again, that sought to assess the confidence levels of participating managed operators. These questions asked for operators' opinions on a diverse range of topics including trading prospects for 2018, the impact of the UK's negotiated exit from the EU on business performance, National Living Wage costs and the business rates revaluation. The results of the questionnaire are presented below.

What are your trading prospects for 2018, as measured in anticipated like-for-like turnover growth?



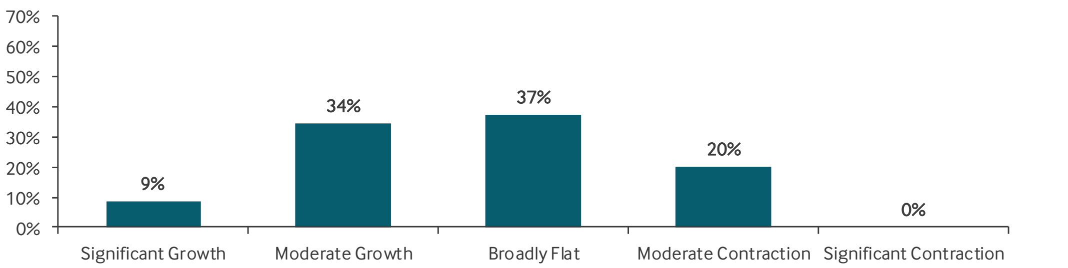
Source: The ALMR Christie & Co Benchmarking Survey

What are your trading prospects for 2018, as measured in anticipated profitability?



Source: The ALMR Christie & Co Benchmarking Survey

What are your trading prospects for 2018, as measured in anticipated headcount?



Source: The ALMR Christie & Co Benchmarking Survey

Operators less upbeat about the potential upsides of Brexit

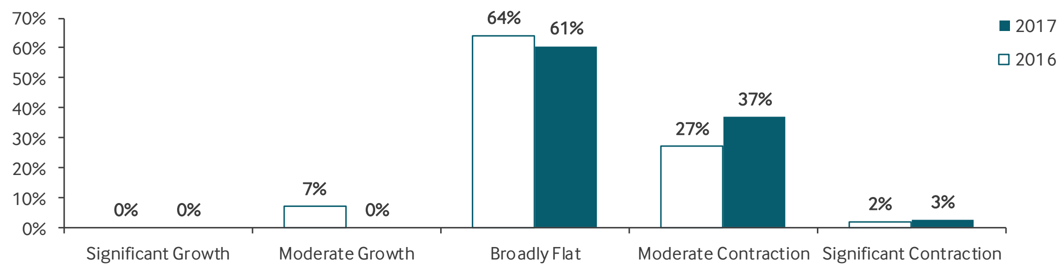
Brexit in 2018 and beyond

The majority of respondents felt that Brexit negotiations would have little impact on their businesses in 2018, though a significant proportion (40%) felt there would be either significant or moderate contraction as a result, with no operators expecting to see benefits in 2018 (7% in 2017).

In the longer-term, half of operators believe that the outcome of Brexit will have no effect on performance, whilst the majority of the remaining operators (39%) felt it will lead to a deterioration in business performance, with only 11% of the opinion that they would see an uplift.

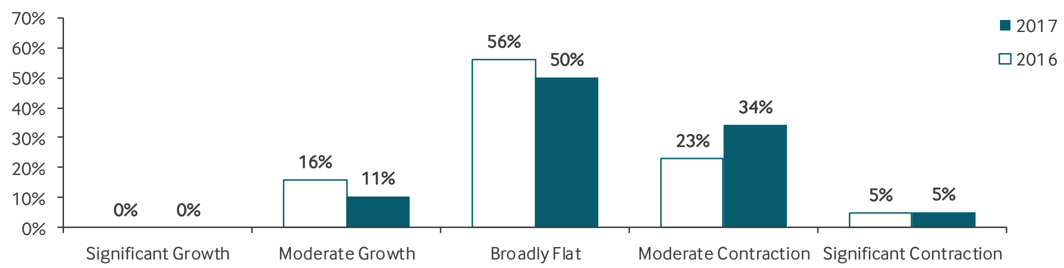
39% of operators now think Brexit will be harmful to their business in the long run

How will the UK's negotiated exit from the EU affect your business performance during 2018?



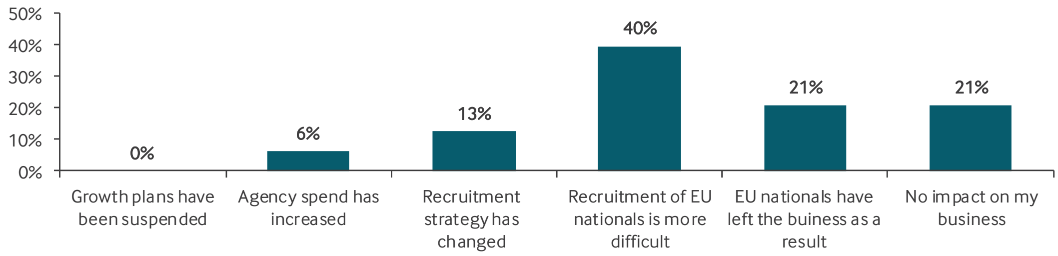
Source: The ALMR Christie & Co Benchmarking Survey

How will the UK's negotiated exit from the EU affect your business performance in the long term?



Source: The ALMR Christie & Co Benchmarking Survey

How has the lack of clarity on EU citizens' rights after Brexit impacted your business?



Source: The ALMR Christie & Co Benchmarking Survey

10. Confidence and Outlook Survey (continued)

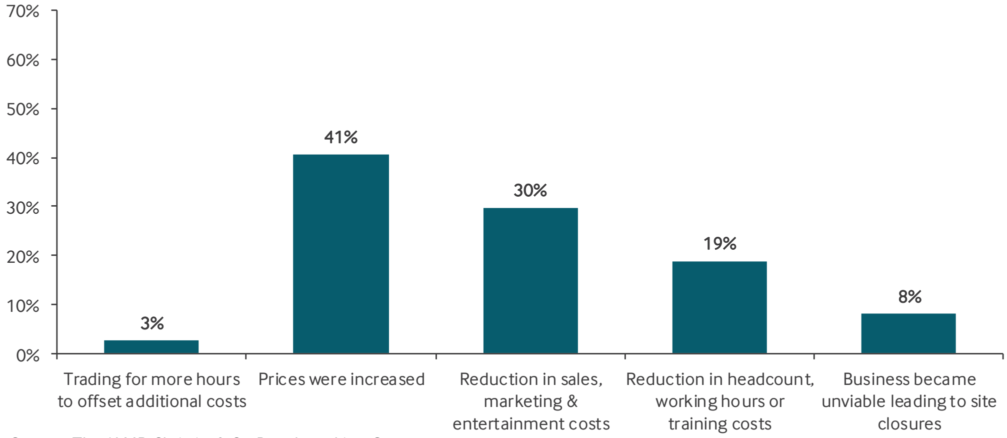
Operators face additional costs to get correct rates bills

All respondents who had used the Check, Challenge and Appeal process felt that it had problems, with 60% believing these to be significant

Business Rates Revaluation 2017

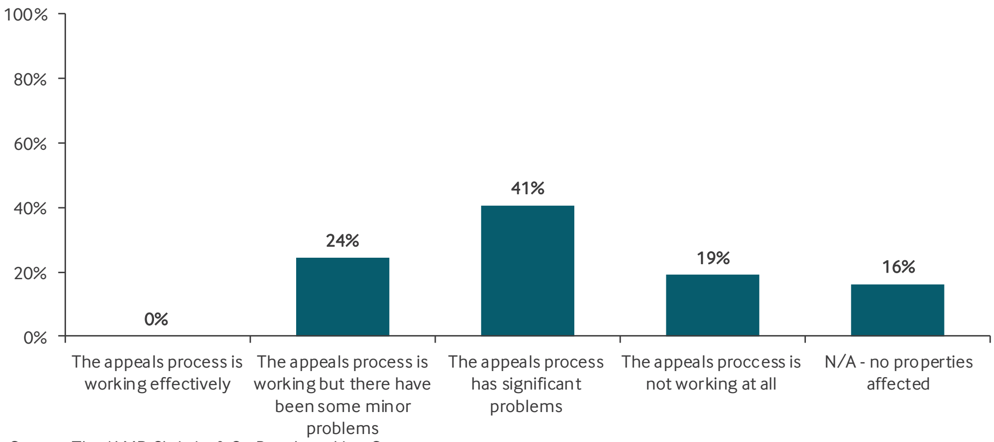
The business rates revaluation took effect in April 2017 within the survey year. 41% of operators' primary strategy was to pass at least some of these costs onto the consumer, whilst 49% reduced staff hours or discretionary spend, such as sales, marketing and entertainment costs. 8% of operators reported that their business became unviable and led to site closures. In the 2017 report, all operators responded that they would seek to challenge excessive valuations. In 2018, 60% of those with properties affected by the revaluation believed that the appeals process is not working at all, or that it has significant problems, whilst 24% believed that the process worked, but had minor problems. None of the operators in the survey thought that the appeals process was without problems.

What measures did your business adopt as a direct result of the April 2017 business rates revaluation?



Source: The ALMR Christie & Co Benchmarking Survey

What is your experience of the new English business rates appeals process, Check, Challenge, Appeal?



Source: The ALMR Christie & Co Benchmarking Survey

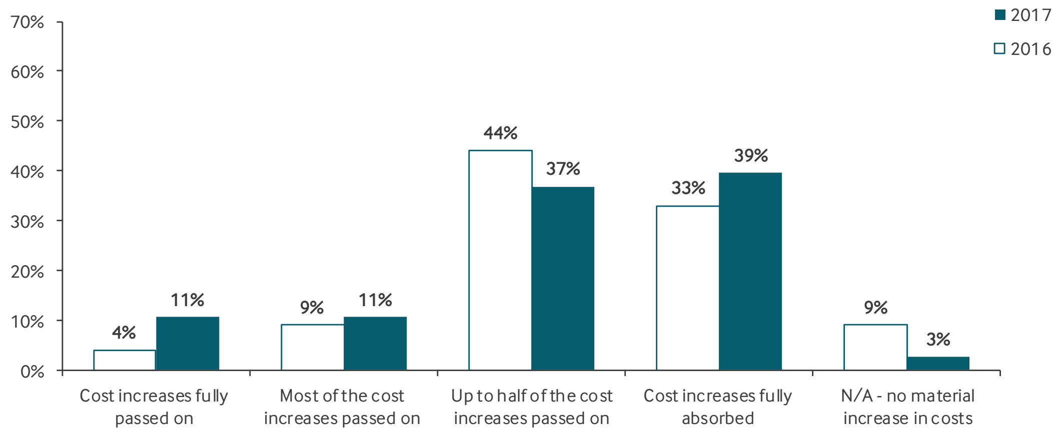
59% of operators raised prices in an attempt to mitigate rise in NLW

National Living Wage

The introduction of the National Living Wage in April 2016 was met with much prophesising over who would ultimately bear the cost – would customers stomach an increase in prices, or would operators see their profit margins eroded? In April 2017, NLW increased to £7.50, and 97% of operators reported a material increase in salary and wage costs as a result. Whilst more operators reported a material increase in costs as a result of NLW in this year's report, they were also more able to pass on these costs to the consumer, with 11% of operators fully passing these costs on.

87% of operators experienced margin erosion as a direct result of the increase in NLW

How successfully has your business been able to pass on any additional costs from the April 2017 increase in the National Living Wage to consumers?



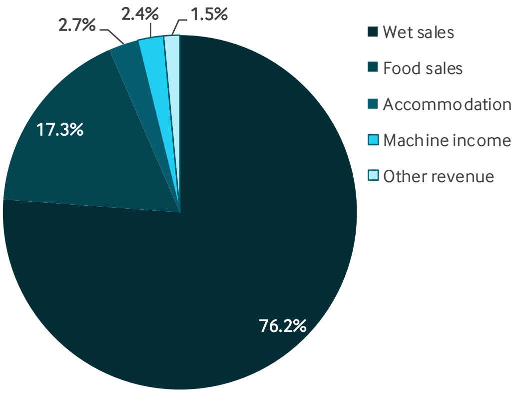
Source: The ALMR Christie & Co Benchmarking Survey

11. Segmental Analysis – Community Locals

Like-for-like growth above survey average, but behind inflation

The revenue profile of Community Locals continues to evolve towards a more rounded offer

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

Community Local outlets are classified as being wet-led and serving primarily a local residential community. They include both rural and suburban outlets.

The survey covered 890 Community Local outlets, 25% of total respondents, moving up from the fourth largest single industry segment in the survey last year, to the second biggest this year. The average Community Local estate was 52 premises, although this is distorted by the inclusion of a number of large operators, and the median of eight outlets is a more typical figure. Data for Community Local outlets was provided from 17 respondent companies, compared to 21 for Food-Led and 13 for High Street pubs.

The turnover profile for the average Community Local is evolving, with food sales increasing 1.1ppt to 17.3% of turnover in comparison with last year's results. Accommodation has seen the biggest increase, rising 1.6ppts to 2.7%. Community Locals historically rely on wet sales and despite a decrease of 4ppts in the year, to 76.2% of turnover, the segment is still significantly more reliant on this revenue stream than the average licensed business (the average across the entire survey was 57% wet sales). This can make the impact of the beer tie more pronounced for these businesses.

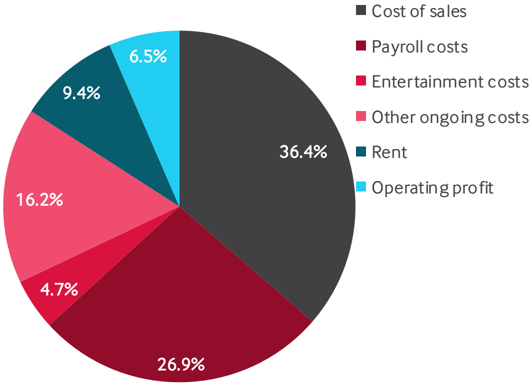
Machine income (after rent) continues to provide a significant income stream for owners and operators, and has remained relatively consistent in its contribution to revenue at 2.4%, up marginally from 2.2% last year. This income stream typically has little or no direct overheads, and as such margin is essentially 100%, making it an essential contributor to operator profitability. This may continue to increase as a result of the Pubs Code, as operators move to free-of-tie leases and therefore retain 100% of machine income, however the number of tenants moving to free-of-tie leases so far has been underwhelming.

Like-for-like revenue across the segment increased to 2.6%, above the survey average of 1.1%, although inflation during the period was 3.9%, therefore indicating contraction in real terms. Margins on food sales have increased to 60.8%, a new Community Local high on the previous high seen in last years report at 59.4%. Clearly, operators have seen the success of Food-Led operators, and where facilities of premises permit, have sought to introduce a better food offering, and as these have increased in scale, so has their efficiency.

Across the wider UK, the Community Local offer has evolved in recent years, with pub companies injecting capital in an effort to make assets more family friendly. Despite this, capital expenditure by operators decreased significantly in the year to 2.3% of revenue, behind the survey average of 3.5%. We do not have granular detail on where Capex is being targeted, but based on the above, we anticipate that it relates to driving food sales and converting upper floors into lettable spaces.

Rising payroll costs

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Operating costs for Community Local outlets have been relatively steady at between 41% and 45% of turnover in each of the previous benchmarking surveys. However, in the current year these costs averaged 47.8%, the highest the segment has seen in the survey's history.

Operating costs in Community Locals tend to be higher in companies with larger estates and this is due to the requirement for a manager in each premises, as well as an area manager for some estates, rather than the owner self operating and not having to pay a manager's salary, which, based on survey responses, is typically 7.4% of turnover within this segment. For smaller estates where a manager is not required at each site, the subsequent cost savings filter through to the bottom line, directly affecting profitability. Some of this year's increase is likely due to this effect.

Community Locals historically allow management to have a more hands-on role, undertaking a greater proportion of the required labour. The responses this year indicate that payroll for the Community Local segment increased at the highest rate of any segment, up 2.8ppts. Some of this will be to service the increased proportion of food sales and room revenue compared with previous years, which require additional labour. Furthermore, those Community Locals that began with lower staffing levels have struggled to find staffing efficiencies to counteract rising wage costs.

Outlook

As with other segments, the weak Pound on the back of the ongoing uncertainty over the UK's economic future and relationship with Europe continued to impact on margins through the period, with the costs of imported products such as beers, wines, spirits and food remaining higher than their pre-referendum levels.

Operators in the segment trading from tied premises are still seeking clarity on MRO legislation, and of recent arbitration awards made by the PCA. This, and public dissatisfaction with the Pubs Code in its current form, may lead to some legislation changes, which could in turn increase the volume of tenants transferring to free-of tie leases going forward, particularly if POBs relax their stance on waiving confidentiality.

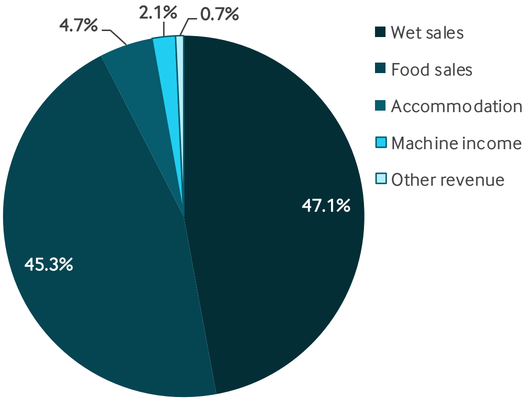
Operating profit margins of 15.9% before rent - down 4.3ppts

11. Segmental Analysis – Food-Led

Flat revenue, but significant inward investment

Food and wet sales at parity for Food-Led businesses

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

The survey covered 1,148 Food-Led outlets, the most prevalent segment amongst respondents at 32% of outlets surveyed. The average size of estate was 55 premises, although this is distorted by the inclusion of a small number of large operators, and the median of four outlets is a more typical figure of the size of respondents estates. Data for the segment was provided by 21 respondent companies.

Faced with declining wet volumes as shifting consumer patterns moved towards off-trade consumption, many pubs converted from wet-led into either mixed or food-led offers in order to drive customer numbers and revenue. This has led us to where we are today, with a significant number of operators now considering these once secondary revenue streams as their primary source of growth and driving footfall.

Like-for-like revenue was broadly flat, increasing only by 0.2% in the year, well below the survey average of 1.1%, and a decline in real terms.

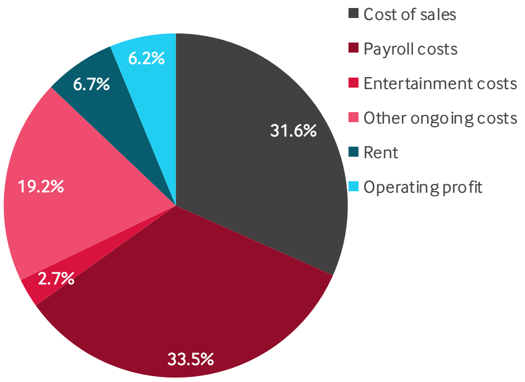
The segment has stalled, as oversupply of dining venues in the UK has increased competition. In reality, the level of competition within the eating out market began showing warning signs during 2016, with pubs having to compete within the same space as over-expanded and aggressively rolled-out casual dining brands (many of whom began reporting negative like-for-likes during 2016 and have since continued to do so), and maintaining any growth during this time was an achievement, and testament to the agility of smaller operators. The situation has since come to a head during 2018, as several dining businesses have entered CVAs. However, these units will need to be converted to other uses in order to resolve the oversupply issue.

The segment saw capital expenditure during the year at 1.8ppts ahead of the survey average, at 5.3% of turnover. This was up 0.3ppts on the previous year, and is a good sign that cash is still being invested in the segment, either in order to achieve growth or merely to maintain market share. As such, if the current highly competitive market can be navigated, solid like-for-like growth could filter through in the coming years, although it's unlikely to be Food-Led in origin in the short term.

Food and wet sales still comprise a ratio close to 50:50, a trend which is in line with the previous two surveys. However, as with Community Locals, there has been an increase in relative accommodation sales, as publicans look to develop high margin letting rooms as a source of future growth.

Maintaining both food and wet offers requires significant headcount

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Cost of sales decreased by 1.9ppts in the year to 31.6% of revenue. We consider this level to be sustainable and it provides confirmation that operators have refrained from turning to heavy discounting in order to drive revenue.

Operating costs accounted for an average of 55.4% of revenue, an increase from the 54.0% reported in the previous year's benchmarking survey.

The largest single contributor to these cost increases was payroll, which increased by 1.1ppts in the period, and remains comfortably at the highest level across all of the licensed segments, at 33.5% of revenue. With a full service commercial kitchen, a manned bar, waiting staff and even accommodation at some outlets, the Food-Led segment can require a higher than average number of staff, and correspondingly a higher level of payroll is expected.

Entertainment costs remained at one of the lowest levels across all the segments, marginally ahead of Casual Dining and Wine Bars, with food continuing to be the principal generator of demand, and operators therefore not deeming it necessary to drive footfall through as many other means.

Outlook

Given the broadly equal revenue mix in Food-Led pubs, the benefit of improved wet margins may not outweigh the costs of going free-of-tie (i.e. a higher rent bill and immediate cash flow requirements) and as a result, tied Food-Led pubs may not have as much incentive as Community Locals to pursue an MRO option.

Any long-term restrictions to the free movement of labour that arise from the Government's negotiations with the EU could impact the ability of operators to recruit and maintain adequate levels of staff in a cost efficient way, which will either add to costs (recruitment) or result in growth opportunities being missed. 21% of operators saw EU workers return to Europe in the year, and we are already seeing some businesses have to adapt their product to be less reliant on obtaining experienced chefs, with simpler offers.

The introduction and subsequent rise in the National Living Wage has affected the wage costs for both front and back-of-house staff. Operators remain split on whether they can pass these additional costs on to consumers, with those in price sensitive areas being reluctant. However, the increased disposable income from beneficiaries of pay differentials being maintained should have brought upside trading potential, although we suspect this has been eroded by the oversupply of dining space mentioned previously.

The business rates revaluation came into effect from 1 April 2017, with the current year including six months at the revised rates. We are expecting premises costs to increase in 2018 as these annualise.

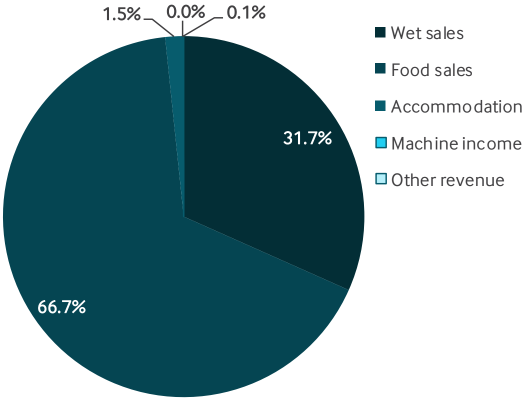
Payroll costs rose 1.1ppts in the year, to 33.5%

11. Segmental Analysis – Casual Dining

A real-terms decline of 3.2% due to oversupply-led competition

Gross profit margins decline in price-sensitive market conditions

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

The survey covered 748 Casual Dining outlets (defined as a restaurant where alcohol sales are chiefly ancillary to food sales), a decrease on the previous year's sample, but still more than sufficient for meaningful conclusions to be drawn. Casual Dining is the third largest segment in terms of respondents, making up 21% of total surveyed outlets.

The average Casual Dining estate consisted of 83 premises, although this is distorted by the inclusion of a small number of large operators, and the median of 20 outlets is a more typical figure. Data for Casual Dining outlets was provided by 9 of the 40 respondent companies.

Food sales unsurprisingly accounted for the majority of turnover, at 66.7%, although this was a decrease of 1.4ppts on the previous year (68.1%) as wet sales increased 1.9ppts to 31.7%, indicating that operators are emphasising their beverage offer, in order to increase spends per head.

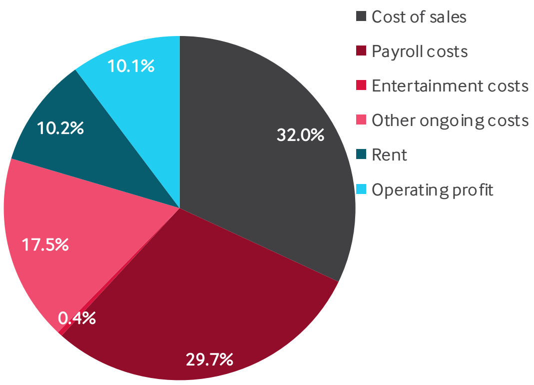
Casual Dining was once held in high esteem as the fastest growing sector of the UK restaurant market, although the tables have now turned, with several large casual dining operators announcing negative like-for-likes over the past two years. Despite this, like-for-like revenue across survey respondents in this segment did manage some growth, at 0.7%, albeit below both the survey average of 1.1% and inflation of 3.9%, indicating a decline in real terms.

Margins on food and beverage sales decreased notably over the period to an average of 67.4% on wet sales and 68.3% on food sales, which compares to wet and dry margins of 70.7% and 69.1% in the previous period respectively. An element of this decrease is likely attributable to discounting and pricing, due to the highly competitive nature of this segment following the addition of 3,000 new restaurant units to the UK over a three year period. Operators have had to fight harder to maintain market share. In addition, the continuation of the subdued value of pound sterling on the back of the referendum and uncertainty over Brexit negotiations has increased costs of imported products, impacting margins.

Capital expenditure of 4.4% for the segment was above the survey average of 3.5%, but 1.5ppts down from the previous year's 5.9%. The frenzy of brand rollout and expansion is now largely over, as investors have realised that investment in the current environment does not guarantee returns. Despite this, capex will not cease, as operators are having to refresh and reinvent their outlets on an increasingly frequent basis in order to maintain market share.

Increase in NLW absorbed but further increases may prove challenging

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Cost of sales increased for the second consecutive year, and together with increased rent, average profitability for a leasehold site has fallen 3.3ppts to 10.1%, suggesting that operating costs have grown at a much faster rate than the anaemic revenue growth.

Payroll saw a marginal increase of 0.2ppts to 29.7% and remains at the upper end of the survey, reflective of the labour intensive nature of the Casual Dining segment. Only Food-Led and Wine Bar outlets have a higher payroll, at 33.5% and 31.6% of turnover respectively. By way of comparison the survey average in the current year was 29.4%.

Unexpectedly, utility costs now average 2.4% of turnover for the segment. This may be in part due to the make up of the survey, with larger respondents generally having increased negotiating power, and perhaps a more proactive approach to switching to the best deals, due to the size of their estates and sophistication of their head office functions. With a full service kitchen operated during the majority of trading hours we would generally anticipate higher costs of operating a Casual Dining outlet compared to a wet-only establishment. Entertainment costs are the lowest across all segments at 0.4%, down further on last year's 1.0%, implying that customers are typically sufficiently entertained by their meals so as not to require significant additional pull factors.

Outlook

As with other segments where efficiencies have been made to mitigate National Living Wage, the Casual Dining segment appears to have swallowed the increased cost base. However, further increases are due from the current rate of £7.83 to £8.57 by April 2020, and as a result the sector will likely suffer margin erosion, as the level of competition in the current market environment will make further price increases challenging.

There is still uncertainty around the outcome of a Brexit deal, which makes business planning challenging. What is known, is that the increasing uncertainty for UK employees from mainland Europe is bad for staffing kitchens, and the segment is already starting to lose confidence from migrant staff. If onerous restrictions on the free movement of labour arise, the effects will surely be felt in the Casual Dining segment, which is traditionally more reliant on migrant labour.

With the midmarket of this segment suffering greatly at the hands of changing consumer preferences, oversupply and increased costs, we anticipate restructuring activity of Casual Dining estates to continue through to at least mid 2019. A significant number of units will have to be taken out of circulation UK-wide before fortunes drastically improve.

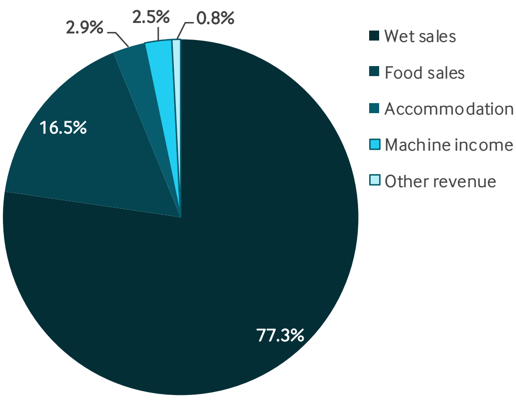
Operating profit margins suffering at the hands of increased costs

11. Segmental Analysis – High Street

High Street segment outperforming Nightclubs and Casual Dining

Entrance fees eroded to below 1% of revenue

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

For the purposes of the survey, High Street outlets are determined to be mixed-use pubs and bars with a hybrid offering differentiated between day time and evening trade. They are situated in town centres and retail locations and will generally have a stronger wet than food offering.

The sample for High Street outlets included 504 venues, a decrease on the previous period. 13 companies in total provided data for High Street outlets, with the average (mean) number of units per respondent company being 39, and the median being six, indicating some distortion by a small number of large operators.

Accommodation revenues increased 1.8ppts in the year to 2.9% as many operators explore how to make the most from the emerging trend of letting rooms. Machine income also nearly doubled, increasing by 1.2ppts to 2.5%.

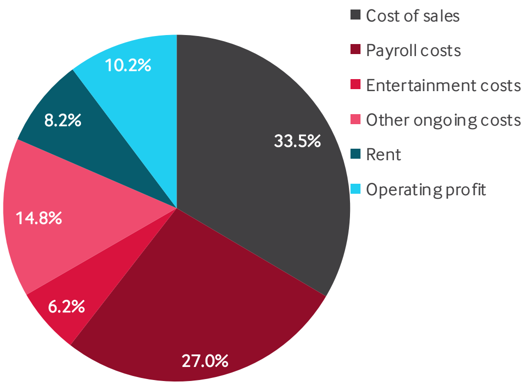
As High Street venues continue to evolve they are crossing segment boundaries to maintain and grow levels of trade. High Street like-for-like growth in turnover has increased from 0.7% to 1.8%, outcompeting Casual Dining and Food-Led operators for day time trade by capitalising on their presence in the high-footfall centres of the UK's towns and cities, successfully promoting their all-day offers.

The High Street segment also competes with the Nightclub segment for evening and late night trade, and on the face of it appears to have to made itself more competitive, as other revenue, which includes ticket sales for entry, decreased as a percentage of turnover by 1ppt. The balance for the High Street segment can be in managing the cross over from daytime to evening trade seamlessly, with consumers wanting a very different offering and atmosphere at different times of day.

We consider that the decrease in wet gross profit margin of 3.5ppts (currently 65.6%) is likely due to a combination of some discounting, as well as inflation pressure on imported goods on the back of the Brexit referendum. Food profit margin increased 0.5ppts in the year to 63.3%.

All day offers remain the holy grail for High Street operators

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Profitability in the High Street segment decreased 2ppts to 10.2% of turnover, with operators suffering declining profitability as a result of wage cost inflation on the back of the increase in National Living Wage; for the 12 month period covered by the survey, payroll increased in the segment by 2.4ppts to 27%.

For operators that can successfully operate outlets to their full potential and create a truly all day offering that attracts a steady stream of customers at all times, assets are sweated harder for the same fixed cost base, increasing profitability as a result. Balance is key, with food offers driving mid-day demand, and the business reliant on wet sales in the evening. Essentially, those agile operators who know their businesses intimately will be able to manage their offer and staff levels to the point where they can maximise revenue during busy periods, but not incur prohibitive staff costs at other times that would otherwise erode the incremental profit from the additional trade.

The typically leasehold nature of the segment (owing to sites being located in town and city centres where freeholds are either prohibitively costly, or unlikely to come to market) impacts the true profitability of these venues compared to other segments where freehold premises are more common.

Outlook

New rateable values came into effect in April 2017, along with an increase in NLW, causing the cost profile of many operators in the segment to change. There were some winners and losers in respect of business rates, however the predominantly town and city centre locations of businesses operating within this segment has weighted this overwhelmingly towards the latter. Profitability is expected to decline further in 2018 on the back of further NLW increases and annualisation of the increased business rates. Some distress, and possibly casualties, are expected.

Management of staff rotas in servicing all day trade continues to be paramount for the segment, as high staff numbers during quiet trading periods has a detrimental impact on margins, whilst lack of staff at peak times not only damages performance but also reputation, which may take longer to resolve.

In a segment where the majority of freeholders tend to be either individual investors or institutions, we do not envisage there to be a significant impact from the Pubs Code.

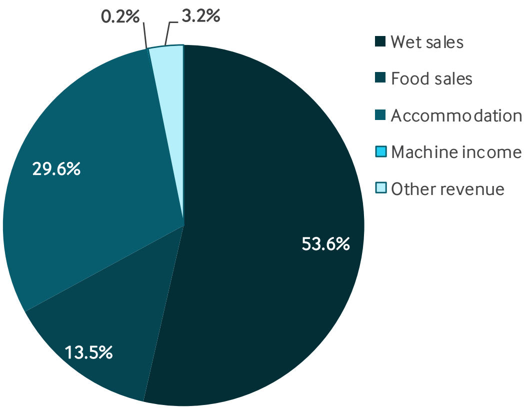
Operating profit margins of 20.4% before rent slightly down from 2017

11. Segmental Analysis – Accommodation-Led

Letting rooms create a more diverse and higher margin business

29.6% of revenue generated from room bookings

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

For the purposes of the survey, Accommodation-Led outlets are those for which letting rooms are a main focus of the business, and contribute in excess of 20% of turnover.

The survey covered 13 Accommodation-Led outlets, representing 0.4% of total surveyed outlets and the smallest single industry segment in the survey. The average Accommodation-Led estate was four with a median of two outlets.

The breakdown of the average turnover profile for Accommodation-Led outlets has evolved, with a significant shift away from food sales and towards letting rooms, with the latter now generating 29.6% of revenue. Letting rooms have grown in popularity in recent years due to their relatively low operating costs leading to higher margins.

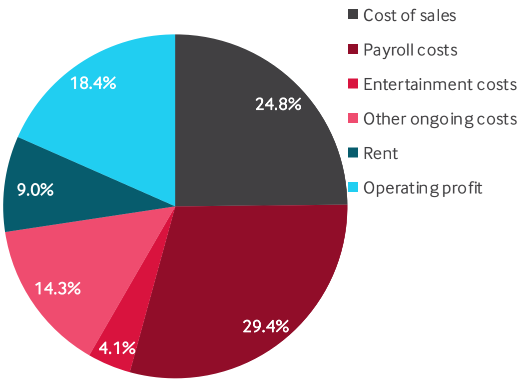
The sector was again the leading segment in terms of like-for-like growth, at 4.1%, which whilst slightly slowed from the level of growth in the previous year (5.1%), is still the only segment showing consistent year-on-year growth of this magnitude (the next highest segment being Community Locals with like-for-like growth of 2.6%), as well as the only segment that has seen growth in real terms.

As well as accommodation sales, wet sales also increased, and now comprises 53.6% of turnover, a reversal in the trend we have seen in other segments, and possibly an indication that even wet-led venues are capable of operating letting rooms. We have certainly seen interest in development of dormant floors or additional accommodation blocks materially increase across all operator segments between 2016 and 2018.

The sector shows strong performance in attracting investment. Although capital expenditure investment in the segment among survey respondents decreased 1.3ppts to 4.6% of revenue, this is still above the levels typically invested to maintain an accommodation premises, which is generally between 3-4% of revenue. This indicates that actual improvements in the quality and quantity of room stock are being made.

NLW increases drive up both operating costs and direct payroll costs

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Along with a strong like-for-like revenue performance, the segment saw operating profit increase by 5.9ppts to 18.4%, reversing the loss seen in the previous year.

Payroll costs and operational costs are intrinsically linked for accommodation providers, with many outsourcing room and/or cleaning functions to specialist service providers. As such, movements in one can be offset by movements in the other as previously outsourced functions are brought back in house and vice versa. However, payroll costs remained flat on last year's results, and operational costs (included in other ongoing costs) decreased 2.4ppts to 4.3% of revenue, meaning an underlying redirection occurred, possibly efficiency-led to bring these in line with longer term averages.

The introduction of the National Living Wage in April 2016, and subsequent rise in April 2017 has not only affected the payroll of the operators but also the payroll of service providers whose staff tend to be paid at-or-close-to the legal minimum wage. As an example laundry costs (which most operators do outsource) are expected to increase due to these service providers passing on their own increased costs. However, we have not seen these cost increases reflected in this year's survey.

Unlike the late night segments, and in particular Nightclubs, the Accommodation-Led segment is generally not reliant on significant entertainment spend to drive revenue. One common key item of expenditure is in the cost of TV packages for the benefit of guests, which amount to 1.1% of revenue. Overall, entertainment costs increased by 0.7ppts to 4.1%, indicating that operators are spending more on entertainment in order to drive footfall and wet revenues.

Outlook

The April 2018 increase in National Living Wage will filter into the results of next year's survey, and we anticipate that this segment may experience some margin erosion due to costs which are outside of the operators' control. It is likely that with further increases in the NLW due each year to 2020, at which point it is forecast to reach £8.57 per hour, payroll costs will rise. However, this will likely continue to be mitigated by high like-for-like growth as letting rooms continue to perform.

The long-term consequences of the 2016 referendum on EU membership still remain unclear. However, at least in the short term, the ongoing supressed value of the Pound has seen the UK remain popular with foreign tourists, supporting the Accommodation-Led segment. However, the wider UK accommodation sector relies heavily on foreign labour, much of it from Europe, and the results of any Brexit deal will affect whether operations in this sector, and hospitality more broadly, continue to be able to recruit personnel to maintain sufficient staffing levels in a cost-effective manner.

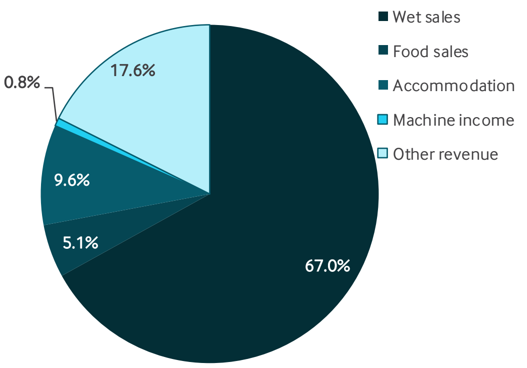
High margin room revenue driving profitability in this segment

11. Segmental Analysis – Nightclubs

Flat performance, but with growth in entrance and hire fees

Other revenue of 17.6% includes entrance fees

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

A Nightclub is classified as a late night entertainment venue. Increasingly onerous restrictions imposed by police and local council licensing departments have impacted this segment significantly in recent years, with such measures including the employment of specific numbers of security personnel, imposition of curfews and the installation of ID scanners, among a number of initiatives. Each of these measures typically either increases the cost of running a Nightclub premises, or reduces permitted opening hours, thereby constraining revenues. Some councils have begun to realise the importance of the late night economy, and taken measures to soften their stance. In London, Mayor Sadiq Khan is pursuing a vision of a 24-hour city through measures such as appointing a Night Czar, Amy Lamé, to help promote and protect the late night economy, and opening the night tube to enable patrons to return home more easily, more cheaply, and more safely.

The survey covered 163 venues, a similar size sample to the previous two surveys (2017: 171 & 2016: 163 outlets) with seven contributors. The sample size remains the third smallest of the sectors, representing 5% of all assets. The median number of outlets is one, with a number of larger operators contributing their data. The consistency of the sample size and respondents will ensure the data remains robust.

In what has been several hard years for the Nightclub segment, operators can take a confidence boost from the second consecutive year of like-for-like revenue growth, albeit a slow down on last year's 3.6% to 0.4%, technically indicating a real terms contraction. This growth is the second lowest of all segments in the survey, ahead of only the Food-Led segment at 0.2%.

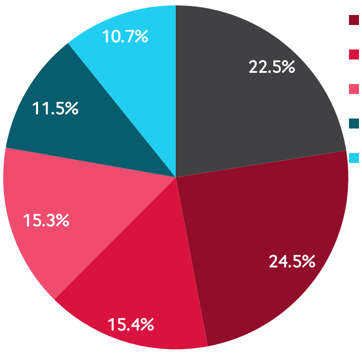
The turnover profile of the average Nightclub venue has evolved since the results of the previous year's survey, with the primary change being a surprisingly significant increase in accommodation of 5.2ppts (to 9.6% of turnover) indicating development of previously unutilised or surplus space. Other revenue, which includes ticket sales and entry fees, increased by 3.6ppts to 17.6%, therefore broadly keeping pace with inflation.

As the High Street segment has increasingly come into competition with Nightclubs for customers seeking late night entertainment, Nightclubs are having to augment their offer with alternative uses of their floor area during the day (and other down times). A focus on food revenue in the segment, which whilst still relatively small, increased by 0.7ppts to 5.1%, the highest level it has recorded in the history of the survey.

Drink prices in Nightclub venues are typically higher than would be charged in bars or pubs, and this is reflected in the gross profit margin on wet sales being 73.3%. Gross profit margin in the sector has remained relatively stable, even increasing slightly over the last three years, with reported margins for during 2016 and 2017 editions being 72.5% and 72.9% respectively.

Simple model leads to good margins and well-controlled payroll costs

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Nightclub cost-profile has remained broadly similar to the previous year, and the second highest segment of the survey, at 55.3% for the period compared to the survey average of 52.5%.

Payroll costs amounted to 24.5% of turnover in the year, a decline of 0.9ppts on the previous year, as operators seek out efficiencies. These costs were the lowest across all segments, and significantly below the survey average of 29.4%, indicating the operating efficiencies of an overwhelmingly wet-led model. However, this is slightly misrepresentative, as significant security costs of 6.9%, which are essential to the trading of such venues, are included within entertainment costs.

Total entertainment costs for the sector are 15.4%, the highest across all segments and significantly above the survey average of 5.4%. This is a result of the need to provide a suitably-diverse array of music and events in order to attract customers. After removing security costs and TV packages, the true discretionary spend on entertainment was 7.9%, more than double any other segment.

Utility costs are on average 2.3% of turnover, tied lowest of the segments in the survey with Wine Bars. This is thought to be due to shorter peak trading hours of premises within this sector, and operators benefiting from off-peak energy tariffs.

Whilst the sector saw like-for-like growth as a whole in the past year, customers of individual sites can be fickle, with nightclubs coming in and out of fashion quickly, thereby creating significant additional risk for operators, and requiring regular refreshment to keep up with trends and reinvent the product. Capital expenditure as a percentage of turnover is 3.6%, in line with the survey average of 3.5%, but down on the 5.7% seen in the previous year.

The sector remains profitable for those capable of maintaining their popularity and relevance, and can reward investors with businesses capable of generating high cash returns.

Outlook

Whilst payroll costs are lower than average, the sector is not immune to the effects of rising wage costs on the back of the National Living Wage, Pensions Auto-Enrolment and the Apprenticeship Levy. It performed well in finding efficiencies this year, which we doubt will be replicable. However, with large and often underutilised spaces outside of peak times, combined with what are already relatively high premises costs, the business rates revaluation presented a significant risk to P&Ls. A return to positive like-for-like growth in real terms is essential if the sector is going to weather annualisation of the above cost increases, as well as further shocks on the horizon.

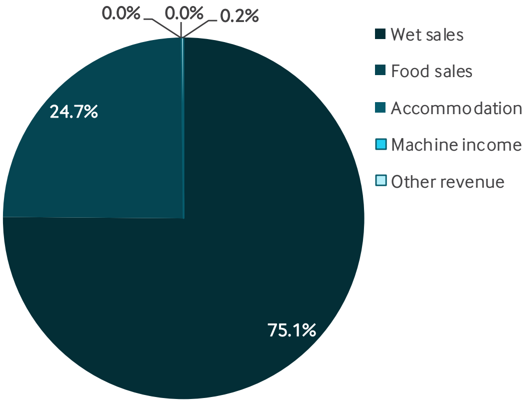
Average operating profit of 22.2% before rent

11. Segmental Analysis – Wine Bars

Second consecutive year of like-for-like growth

Food sales decreased by volume, but improved in terms of gross profit margin

Revenue Composition



Source: The ALMR Christie & Co Benchmarking Survey

A Wine Bar outlet is defined as a café or bar-style operation, differentiated from other wet-led operators by the fact that it is primarily seated and has a stronger food offering.

As discussed in the High Street and Casual Dining segments earlier in this report, the ability to conduct all-day trade is becoming an increasingly essential ingredient for the success of a business, allowing operators to cover their fixed costs easier by sweating assets harder. The Wine Bar segment is well placed to take advantage of this, and although primarily seated, dwell times are likely to be shorter than in traditional full-service restaurants due to café-style operations, enabling a higher turnover of customers during the day.

Data for the segment was provided by five operators covering 118 outlets, 3% of the total survey sample and the second smallest segment in the survey behind Accommodation-Led outlets.

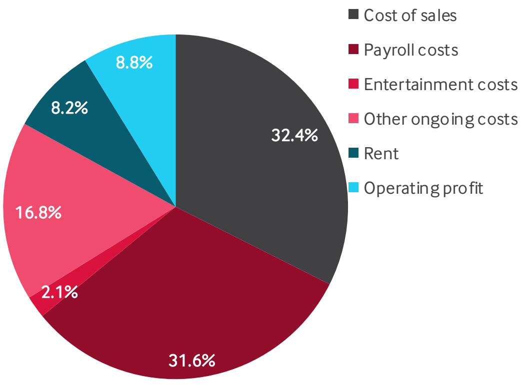
The average Wine Bar estate across respondents is 24 venues, with the median being 16.

The segment remains heavily reliant on wet sales, of which coffee is a major factor for many, which account for 75.1% of revenue. Surprisingly, food sales, which is an increasingly important aspect of sales, have decreased as a percentage of turnover by 2.2ppts to 24.7% in the year. Despite this, gross profit margins on those food sales have increased marginally, as operators improve operational efficiency and pricing.

Like-for-like revenue growth during the year was 1.4%, which is marginally ahead of the survey average of 1.1%, and the second consecutive year of growth for the segment after a period of contraction. Wine Bars (although not cafes), the High Street and Nightclubs are often geographically close and increasingly competing with each other for trade. As a result growth in one can often mean cannibalisation of demand from the other two. However all three are currently in growth, at least in nominal terms, and this can be taken as a positive sign.

Rent reductions and margin improvements give hope to operators

Cost and Profitability



Source: The ALMR Christie & Co Benchmarking Survey

Expressed as a percentage of turnover, payroll costs increased by 2.4ppts to 31.6% in the year, which is higher than the survey average and representative of operators struggling to find further efficiencies to offset the increase in wage costs on the back of NLW increases, the Apprenticeship Levy and Pensions Auto-Enrolment, all of which hit in April 2017, and were yet to fully annualise in the results presented.

Assets within this segment have previously had the highest level of rent when measured as a percentage of turnover and usually in the region of 11-12%. This year, however, the segment has one of the lowest rents in the survey at 8.2%, a decrease of 2.9ppts. This compares to the average level of rent across all survey respondents of 8.5%. This has caused operating profit after rent to almost double when compared to last year's report, and achieve a more equitable split between landlord and operator.

A number of high street premises obtained rent reductions during 2017 and 2018 as the market turned, and we consider this fall in rents to be both justified, and the result of negotiations with Landlords.

During the survey period there was a slight recovery of the GBP against the Euro and US Dollar, and as a result the cost of imported wines would have been slightly alleviated, although still increased, and well behind the favourable prices pre-referendum. Operators in this segment seemed to have successfully passed these costs on to the consumer, as respondents reported an improvement in wet gross profit margin of 4.6ppts to 69.1%. Gross profit margin on food sales also increased in the year, from 61.9 % to 62.9%.

Outlook

Although a slight recovery has been seen, the Pound remains weak compared to the levels seen pre 2016, on the back of an uncertain outlook in terms of the format of any negotiated exit from the EU and we do not anticipate gross profit margins increasing significantly as imported goods remain more expensive in relative terms.

The introduction and subsequent increases in the National Living Wage has increased wage costs for the lowest paid serving and bar staff. Whilst some efficiencies were found at its introduction, there is generally very little room for manoeuvre. As a result, future increases in NLW and Pensions Auto-Enrolment are expected to impact profitability, at least until 2020, from which point further increases are expected to be in line with inflation (as opposed to exceeding it).

Average operating profit of 17% before rent

12. Conclusion

A diverse and resilient sector with plenty of opportunities

Operating costs now at 52.5% of turnover, and likely to increase further

Nominal like-for-like growth was enjoyed by all segments in the licensed sector for the second year running, with the entire survey average consistent with last year's report at 1.1%. Coupled with a continued shift that has seen operators focus on growing food revenue streams, which reached a new high point of 36.5% of revenue, and accommodation sales, which continued to be assisted by the referendum's effect on the value of the Pound, and the sector continues to prove itself as diverse, resilient, adaptable and full of opportunity.

We passed the peak of the investment cycle in 2017, with capital expenditure now at a local low point, yet still above levels seen during the recession. Given the rise in costs seen in the same period, most of this capital expenditure is likely to be defensive in nature, as operators have fought to remain competitive and provide an attractive and enticing offer. We may see premises costs increase due to more requirement for repairs and maintenance on the back of these low capital expenditure levels in future surveys as a result.

Investment into new openings, the main engine of growth in the sector in recent years, also stalled on the back of the implosion of the casual dining sector. Aggressive rollout plans in the wake of the recession have proven themselves unsustainable, as the market has struggled to digest the addition of 3,000 additional restaurants in the space of three years. Oversupply and unsatisfactory performance became very public in 2018 as a number of high profile restaurant brands went through restructuring plans and CVAs, which will likely manifest in the next edition of the report. The silver lining for the sector is that rents have begun to decline as a result of a shift to more cautious brand rollout strategies, and thus reduced competition for sites.

Last year, we accurately predicted that the average overheads associated with running a licensed premises would increase as cost pressures affecting payroll and property cost categories began to filter through P&Ls. Operating costs now stand at 52.5% of revenue, an increase of 1ppt in relative terms (as a % of revenue) in a single year. That's a decline in margins of 1ppt on average. Results vary between diverse segments of the market, but costs rising at this rate presents a significant challenge for operators, and is simply not sustainable.

Payroll costs continued to rise on the back of the NLW increases that took effect in April 2017 as well as the impact of the Apprenticeship Levy and Pensions Auto-Enrolment. At 29.4% of turnover, this cost category remains the most significant cost for operators, and further cost rises are anticipated as these increases annualise, and next year's increase comes into effect. Property costs rose on the back of the business rates revaluation, which came into effect in April 2017. These are expected to increase further in 2018 as these costs annualise.

The key uncertainty on the horizon remains Brexit, and the likely structure of the UK's relationship with the EU after 29 March 2019. It is concerning that there is no additional clarity over this despite it being a year since writing the last edition of this report. Impact will be felt in business' ability to recruit and retain talent, source products from overseas cost-effectively, and reap the benefits of tourism. Ensuring that we, as a country. get this right is of paramount importance.

Operating any consumer-facing business successfully during a period of uncertainty is challenging, and we encourage operators to utilise this and future reports to benchmark themselves against the market and improve their businesses on both a strategic and operational level.

APPENDICES

Appendix I – Illustrative Survey Format

THE ALMR CHRISTIE & CO BENCHMARKING SURVEY 2017

Results for the year to September 2017

Please take the time to complete all three sections of this survey as carefully as possible. Sections 2 and 3 can be found on the following tabs. We greatly appreciate every response received, and provide a copy of the Benchmarking Report to each respondent in years that they contribute at no cost.

Company Name

Please note that information will be held in strict confidence, and company name is required for administrative purposes only (e.g. to assist with chasing non-respondents).

Section 1 **Outlets, ownership and operation**

1a How many outlets do you have in total (all ownership and operation styles)?

1b The following table should be completed for your **MANAGED ESTATE ONLY**

Number of managed outlets by ownership, operation and trading style

	Community Local	Food-Led	Casual Dining	High Street	Licensed Accommodation	Nightclubs	Wine Bars	**Total**
Total managed outlets								
of which Freehold sites								
Leases/tenancy sites								
of which Commercial or free of tie lease								
Tied or industry lease/ tenancy								
of which Wet tie only								
Gaming machine tie only								
Wet and gaming machine tie								

Definitions:

Community Local: A wet-led pub, serving a local residential community – rural or suburban
Food-Led: A pub where the food offer is a major driver of demand, and food sales are significant to overall sales (30%+)
Casual Dining: A restaurant where the main focus of the establishment is the provision of meals
High Street: A wet-led "circuit" or town centre bar or branded Young Persons Venue (YPV)
Licensed Accommodation: An establishment where letting rooms are a main focus and significant to overall sales (20%+)
Nightclub: A late night entertainment venue
Wine Bars: A seated café or bar style operation

Financial information - managed outlets

Section 2

Please complete all cells within the table below by providing the requested financial information in terms of the AVERAGE % OF NET TURNOVER (i.e. excluding VAT) for your MANAGED ESTATES ONLY, grouped by trading style, for the 12 MONTHS UP TO AND INCLUDING 30 SEPTEMBER 2017 (or as close as possible to this date based on your organisation's period end dates). Please give separate data for each market segment as defined in section 1 of the survey, and please give figures for each category and sub-category available – e.g. Staff, Manager and Total Payroll Costs - as this helps us to validate responses received and ensure the accuracy of our subsequent analysis.

Definitions (in order of appearance)

Other sundry revenue	All other revenues not listed out specifically (i.e. not including wet sales, food sales, accommodation revenue, gaming machine income). Common sources of Other sundry revenue include room hire and door charges
Gross margins	The proportion of money left over from revenues after accounting for the cost of goods sold (COGS), but before payroll and other costs
Costs	For the purposes of completing the below table, costs are those accounted for at a site-by-site level and exclude those typically borne by head office such as legal costs, financing costs, depreciation and amortisation, central marketing costs, etc.
Total Payroll Costs	Staff plus manager costs
Staff Costs	Staff wages and salaries including bonuses NICs and PAYE
Manager Costs	Manager's salary and bonuses or fees as applicable
Total entertainment costs	Sky or other subscription (where applicable) plus Security and door staff plus Other entertainment
Other entertainment	The cost of PPL/PRS fees, background music, live entertainment, marketing and promotions
Utilities	The cost of electricity, gas, other fuels, water, sewerage, and waste disposal
Operational costs	Cleaning (including associated staff costs), laundry, glassware, telecommunications, stocktaking, credit card charges and any other operating costs
Premises costs	Includes rates, insurance and minor repairs, but excludes rent
Other ongoing costs	All other site costs not listed out specifically, excluding rent and capital expenditure

	Freehold Estate								Leasehold / Tenanted / Other Estate								Total Managed Estate
	Community Local	Food-Led	Casual Dining	High Street	Licensed Accommodation	Nightclubs	Wine Bars	**Total**	Community Local	Food-Led	Casual Dining	High Street	Licensed Accommodation	Nightclubs	Wine Bars	**Total**	
Trading information																	
Like-for-like % change in turnover year-on-year																	
Turnover mix as a % of total sales																	
Wet sales																	
Food sales																	
Accommodation																	
Machine income																	
Other sundry revenue																	
Gross margins - *% of total net turnover*																	
Wet																	
Food																	
Other																	
Operational costs - *% of total net turnover*																	
Total payroll costs																	
of which Staff																	
Manager																	
Total entertainment costs																	
of which Sky or other subscription																	
Security and door staff																	
Other entertainment																	
Utilities																	
Operations costs																	
Premises costs																	
Other ongoing costs (excluding rent / capex)																	
Rent																	
Capital expenditure - % of total net turnover																	

Section 3 Please select the most appropriate answer for each of the following questions, answering from the perspective of the current opinion of your organisation as a whole:

		Significant contraction	Moderate contraction	Broadly flat	Moderate growth	Significant growth
	What are your trading prospects for 2018, as measured in...					
3a	...anticipated like-for-like turnover growth?					
3b	...anticipated profitability?					
3c	...anticipated headcount?					

		Significant contraction	Moderate contraction	Broadly flat	Moderate growth	Significant growth
	How do you think the UK's negotiated exit from the EU will affect your business performance...					
3d	...during 2018?					
3e	...in the long term?					

		N/A - no material increase in costs	Cost increases fully absorbed	Up to half of the cost increases passed on	Most of the cost increases passed on	Cost increases fully passed on
3f	How successfully has your business been able to pass on any additional costs from the April 2017 increase in the National Living Wage to consumers?					

		Businesses became unviable leading to site closures	Reduction in headcount, working hours or training to offset additional cost	Reductions in sales, marketing and entertainment to offset additional cost	Prices were increased to offset the additional cost	Trading for more hours to offset additional cost
3g	What measures did your business adopt as a direct result of the April 2017 business rates revaluation? (Please tick all that apply)					

		N/A - no properties affected	The appeals process is not working at all	The appeals process has significant problems	The appeals process is working but there have been some minor problems	The appeals process is working effectively
3h	What is your experience of the new English business rates appeals process, Check, Challenge, Appeal?					

		No impact on my business	EU nationals have been leaving the business as a result	Recruitment of EU nationals has become more difficult	The business' recruitment strategy has been changed	Agency spend has increased	Growth plans have been suspended
3i	How has the lack of clarity on EU citizens' rights after Brexit impacted your business? (Please tick all that apply)						

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