

# Horizons Review of the Year 2011

## Contents

<b>2011</b> .....	1
<b>The numbers</b> .....	1
The year as a whole .....	2
<b>Sector Review</b> .....	3
<b>Suppliers</b> .....	4
2012 .....	5

To discuss any of the issues raised in this review, contact Horizons on +44 (0)20 8349 0162 or [info@hrzns.com](mailto:info@hrzns.com) or visit our website [www.hrzns.com](http://www.hrzns.com)

## 2011

During 2011 the global financial community coalesced its views on the state of the worldwide economy. It came to the clear conclusion that the amount that had been lent over the good years now exceeded the assets underlying the loans or, depending on your view, borrowers, collectively, lacked the ability to repay their loans.

Hence money was no longer being made available by those who had it to those who hadn't.

This comprehensive systemic failure is playing itself out in millions of ways around the world. Our concern is the micro-world of eating out, in the UK.

Here consumer confidence has taken a hit. It is negatively correlated with fears over unemployment – if consumers believe unemployment will rise their confidence falls, and the sharper the perceived rise in unemployment, the faster the fall in confidence.

And the eating out market depends, in large measure, on consumer confidence both for its overall development and its shape in terms of where people eat, what they eat and how much they pay.

Of course, not all sectors depend on consumer confidence – some depend on government confidence, or at least the willingness of government to spend.

Overall, the foodservice market continued to demonstrate its flexibility and although it declined in 2011, the fall was modest compared with many other sectors of the economy.

So much for the big picture. How has it played out in more detail? And where will it take us in 2012?

## The numbers

We will be producing our definitive and detailed statistics on the UK eating out market at the end of March 2012, when all the results are in. In the meantime, we will produce our first estimate of how the sector performed in 2011, at the end of January in the next edition of Quarterly Briefing Report.

So, while we wait for some more clarity and while the results of the important Christmas trading period are not yet in, we present here are our preliminary estimates for the past year.

Putting the year into context, 2009 and 2010 both saw some growth in nominal terms once the impact of inflation has been added in – without inflation though, the market fell in terms of consumer spend in both years.

2011 was worse, we believe, since all the signs are that it fell in both nominal and real terms – something which hasn't been seen since we started recording changes in 1981. The overall foodservice market was probably down (-3 to -5%) in volume and in real prices i.e. without allowing for inflation. Inflation to mid June was 4.2% before allowing for ways in which consumers mitigated their cost of eating out such as choosing cheaper menu options, using discounts etc

So 2011 was an extremely challenging year for the majority, though not for everyone and it is a testament to the flexibility of the sector that amidst the gloom there has been light. The following summary attempts to capture both sides of what happened during the past year.

## The year as a whole

2011 started off slowly and got even slower:

- The commercial and non-commercial sectors both suffered during the year but for different reasons.
- The non-commercial (or cost) sector was hit as Government expenditure slowed down in health and education – two key volume markets for foodservice suppliers even if margins are thin.
- The commercial (or profit) eating out market fell in “£ in the till” terms. Because inflation has been evident, the actual downturn in nominal terms is less obvious than it would otherwise be – but it is still likely to be negative.
- Nevertheless, there were pockets of growth in the commercial sector which are identified below.
- Confidence is now a key driver in eating out in light of the economic climate in general and unemployment in particular. It took a bad knock during 2011 – but not as bad as in late 2008 – the rot started at about the time of the August Riots and although they did not cause the downturn, they may have been the straw that broke the camel's back in terms of consumer confidence.

However, being somewhat positive:

- The eating out market – overall – held up pretty well.
- That was partly an illusion, however, because London accounts for 28% of discretionary eating out (restaurant, quick service, pubs, hotels and leisure sectors) and consumers there are still moderately positive – borrowing is cheap (so mortgages are controllable), there is a bit of activity from rich overseas visitors (Chinese, Russians looking for places to stash their money such as £40 million flats in Knightsbridge) etc.
- So while London was performing satisfactorily, other parts of the country weren't – especially regions such as Northern Ireland and the North East which are dependent on Government expenditure for a significant chunk of their local economy.
- Average menu prices remained steady and new products were launched onto menus – although the average price paid by consumers fell – as a result of discounting and consumers selecting cheaper menu options and/or foregoing starters, desserts or side dishes.

## Quarter 1

- The year started off better than could be expected, but primarily because comparisons were with a snow-hit January in 2010. February continued well, but in March the market turned distinctly downwards on the back of declining confidence.
- VAT was increased from 17.5% to 20% on 4 January and much of the increase was passed on by operators – and customers did not overtly object.
- Government spending cuts started to bite with both central and local government announcing where and how their spending reductions would occur.
- Eating out in most of the country struggled though there were pockets of exception, in major provincial areas, such as Manchester.
- And London bucked the trend. The City was still having a good time, with bonuses much higher than the year before. At the same time, high-spending foreign visitors were making their way back to London, notably those from Asia, and especially China. Beneficiaries included hotels, lunchtime restaurants in central areas and lunchtime take aways in financial and business areas. Casual dining (with an average spend of £10 - £20, averaging around £15) performed notably well.

## Quarter 2

- The quarter benefited from a benign April, but May and June showed underlying signs of weak demand. The non-commercial sector started to suffer from reduced government expenditure.
- Consumer expenditure on eating out was up in the quarter due to the VAT increase and some positive year-on-year comparisons, but meal numbers and food purchases were down.
- The cutbacks in the non-commercial foodservice sector continued and reductions in local authority expenditure on long-stay care exposed shortcomings in the business model at Southern Cross.
- Branded managed restaurant chains – both quick service and full service, continued to outperform their peers. In other sectors, food became increasingly important to pubs with all the major managed estates now reporting that food accounts for well over 40% of their sales.

## Quarter 3

- There was some apparent sales growth in the summer and into the autumn hiding reduction in meal volumes. The reality was that sales were down in real terms, meal numbers were down and margins were being squeezed.
- Consumer confidence took a knock on the back of growing concerns about the global economy. Nevertheless, the amount spent by consumers per meal increased.
- Food inflation reached almost 8% in September, adding to operators' costs and generally limiting their room for manoeuvre.
- However, as we note later on, chain operators as a class performed moderately well although even their performance showed signs of falling off towards the end of September.
- Discounting, which had been reduced into the first half of the year and was well below the levels in 2010, started to return.

## Quarter 4

- Apart from comparison with a snow-hit December 2010 (and even part of November 2010 in some regions), business was probably down in the quarter compared with a year ago.
- It was difficult to find bright spots except London; some individual operators continued to report positive news but growth figures were lower than in 2010.
- Inflation started to ease off, but discounting continued to grow and was higher in November than in the same month last year.
- Once again, Christmas was "arriving later than ever" – which translated into a soft market with meal numbers up on (snow hit) December 2010 but spend per head down – especially since company-funded events were fewer in 2011.

## Sector Review

### Restaurants

- Despite outperforming the restaurant market as a whole, chains increasingly suffered during the year with a progressive slowdown in their rate of growth – probably as a result of activity by managed pubs which compete in the same space.
- Discounting, after a slow start to the year (operators were probably trying to wean themselves off them), started to grow by mid-year – and was higher in November than a year earlier. In other words, chain restaurants were having to fight hard on the price front.
- Apart from investing in discounting, branded restaurants were investing in marketing, new branding (at Pizza Express for example), opening new outlets (Jamie's Italian, Byron and more) and acquiring business/units from failed restaurants with purchase prices moderately low and borrowing costs benign.
- Failures among group operators were few, but included Paramount, the business that owns Chez Gerard.
- Independents didn't do as well as branded restaurants because they tend to be outside London (where business was OK) and they lack the buying power/marketing muscle of group operators.

- As pubs expanded their food offer through the year, a growing number found that dry sales exceed wet, and, consequently (on the basis of Horizons definitions) the number of pub restaurants increased.

#### Quick Service

- Fast food, American-style chains – McDonalds, KFC etc, but also Costa, Pret a Manger – broadly held up during the year on the back of new product launch initiatives, in-store promotions, evolving their offers to suit changing customer tastes and increasingly high visibility.
- Some chains (including Domino's whose online and mobile ordering platforms took off during 2011) reported good growth due to new store openings while like for like sales slowed down.
- In this sector, too, independents really suffered during the year because of increasing costs (utilities, taxation, and regulation) and depressed sales. Margins and profitability were hit. Failures included Napket and Mas Burritos.

#### Pubs

- Managed pubs (Mitchells & Butlers, JD Wetherspoon for example, and also managed estates within Marston's, Greene King etc) performed between OK and well.
- Food sales per customer were up in most of these estates, although the rate fell as the year progressed and may have been less than inflation for the whole year.
  - Pubs were able to stabilise (and in some cases reduce) food selling prices because they have another income stream – namely alcohol – which has a higher net margin: Thus, it is in their interest to minimise their customers' spend on food to allow maximum expenditure on booze
  - The other side of this coin is that on-trade alcohol sales are declining overall – which means that even if food sales are static, their share of pub sales increases.
  - This is a pub sector-wide issue that individual companies can ignore only so long as their wet and dry sales are both increasing.
- Business failures included Balls Brothers, Cougar Leisure, Dukedom, J&G Inns and Tom Wood Pubs.

#### Hotels/Leisure

- Hotels, especially larger, more expensive ones, in London held up well and showed reasonable year on year increases as a result of the growing influx of overseas visitors – in both business and pleasure.
- Mid-spend hotels in the country, seaside etc. benefitted, but only slightly, from staycationing Brits.
- Budget hotels have taken business from both the higher and lower-end of the market, but they don't make a feature of food because they have little or no conferences and functions, a limited breakfast offer – and customers often eat elsewhere.
- Luminar and Von Essen Hotels were high profile business failures.

#### Contract catering / Staff feeding

- This sector suffered, and will continue to suffer, because of rising unemployment.
- Larger players, notably Compass, were aggressively growing business from facilities management accounts - their pure food offers were under threat.
- Smaller and mid-size players were able to pick up business on the basis of costs.

#### Institutional sector

- Government cutbacks reduced demand throughout the year
- The education sector performed better (or less worse) than health care
- Care homes struggled because of reduced funding (failure in the case of Southern Cross)

#### Suppliers

- Suppliers - manufacturers and distributors - found their margins squeezed everywhere
- While there had been plenty to play for – volumes may have fallen but they were still large – comparisons with previous years made grim reading. Business was being won or lost on price rather than service.

- However, there was room for imaginative solutions to pressing problems and Compass switched their major supplier on the back of substantial savings arising from reducing complexity in their supply chain.
- There was some (possibly token) demand for higher value products – certainly there was pressure throughout the year not to allow quality to suffer.

## 2012

Our topline view:

- The recent run (ie continuing real decline) will continue into 2012.
- The economic climate will worsen – and we expect consumer confidence to continue to erode, as news about rising unemployment (with the creation of private sector jobs unlikely to match cuts in the public sector) fuels fears over spending.
- This means that foodservice is likely to have a worse 2012 than 2011.
- During the year the pressure on margins will undoubtedly continue and will probably get fiercer as operators seek even lower prices – with no commensurate reduction in quality.
- However, brands will continue to outperform the market because, as a class, they have deeper pockets than independents.

We start the new year on the back of a year most would prefer to forget. In most years, such a position presages a year of consolidation, if not growth, as players seek new opportunities amongst the failed business and business models of last year.

But 2012 comes along after more than three full years of retrenchment and there are few reasons to be positive.

Continuing the negative theme for a while more, the global economic scene will continue to colour what happens in the UK eating out sector.

Events in the Eurozone will develop in one of three ways: muddle through, collapse or fiscal consolidation. While any of these are possible, it is likely that politicians will continue to mumble and stumble, adding to the uncertainty and often putting personal profile and national priorities ahead of a multi-national solution to the fiscal problems

The US has no budget – an amazing state of affairs for the largest economy in the world – and until it does, the economy will lurch and stumble. Nothing practical can be expected during 2012, election year.

The global financial community has some confidence in the UK as a reasonably safe place to store money, but this confidence can evaporate for any number of reasons. If it does, there will be national anguish. But more importantly, sterling will fall, inflation will rise, borrowing costs will grow as interest rates rise and therefore there will be less money for the government to spend as it might like, leading to more austerity.

Thus, for a range of reasons, confidence is unstable.

Furthermore, although the number of corporate failures in the UK eating out sector has been fairly benign, balance sheets have been stretched during 2011 and it will not take much to see the rate of failures rise, probably as early as the first quarter.

Meanwhile discounting will probably continue to rise after the attempt by operators to cut back in 2011 - the goal of increased customer traffic is too significant to ignore.

The cost of food to the foodservice sector reached a three year high in September – the good news is that it wasn't as high as the 13% reached in August 2008 and most commentators expect it to fall rapidly for the whole of 2012.

Another piece of potential good news is that the 2012 Olympics could, just possibly, lead to more eating out, an uplift in confidence and, longer term, a legacy of global appreciation for British food and hospitality. On the other hand, maybe the visitors won't come and the improvement in reputation won't happen. Over the coming months we will be examining the

potential for the eating out sector, but right now, our modelling, based on reasonable assumptions (for instance that there are 10% fewer visitors to Britain than in normal years), that the UK eating out market will be £100 million worse off.

There will be increased business for operations active "inside the fence" i.e. with contracts to supply at Olympic venues. But "outside the fence" things could be grim if normal visitor numbers stay away (tour operators around the world are reportedly advising clients to go to Paris, Rome, ABL (anywhere but London) – their lost numbers won't be made up by day-visiting Britons, media, officials and athletes.

Then there is the Royal Jubilee. Whilst there is unlikely to be anything but a very localised uplift in demand for short periods, it could possibly have some positive impact on sentiment – but this is not likely to increase foodservice sales per se.

All in all then, there are no real grounds for optimism except perhaps this: the eating out sector has shown resilience over the years by creating new concepts (up-market burgers, coffee shops), developing new business models (all day trading, pub franchising), becoming smarter in the ways that it serves food (sharing platters), tapping into consumer's changing needs (selective discounting, home delivery) and modifying its cost base (in thousands of ways).

And as a result, when the eating out sector has a bad period – as it had in 2011 (and 2010 and 2009) - the decline is small, in the order of minus two or three percent. While unhappy, or disastrous, for individual operators, the outcome for the sector as a whole is relatively modest.

In short, the eating out sector copes well with change.

Balancing the many bad things that can happen over the course of 2012, with the fewer good things, we foresee 2012 as another year of decline.

Nevertheless, there are many things that operators - and suppliers - can do to be successful in 2012:

- Continue to control costs
- Innovate in all aspects of the business – operations, marketing, quality, service, pricing
- Use marketing – social media, and otherwise - to continue developing relationships with customers
- Improve menus imaginatively
- Invest in staff training
- Revamp premises to improve the customer experience, enhance efficiency, create opportunities for more business
- Capitalise on the Olympics