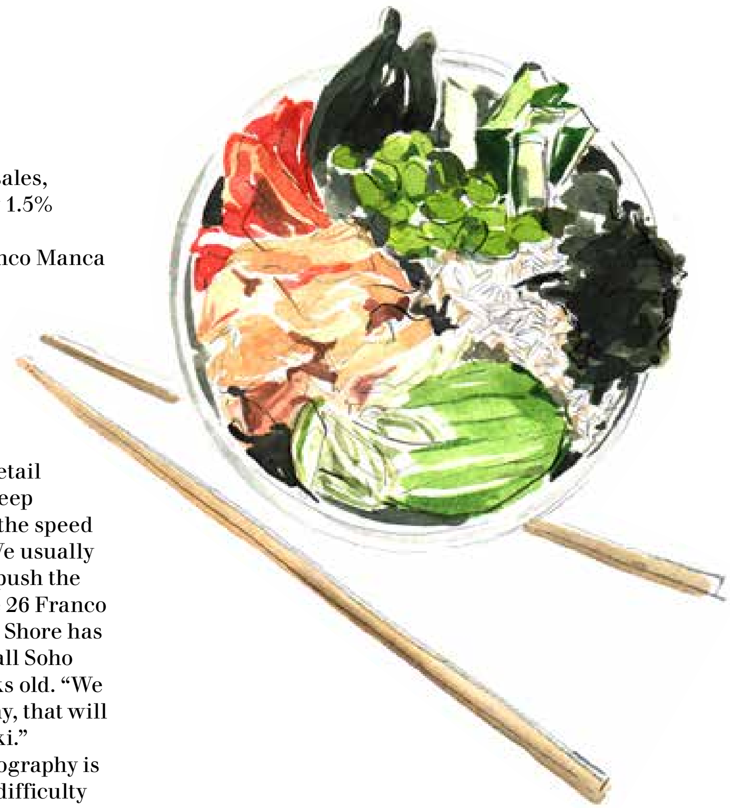
Pizza the profits

UK restaurant sector's strong growth and prospects has whetted investor's appetite. But uncertainty over Brexit and extreme competition mean investors have to get creative with where they put their money

PizzaExpress, Côte, ASK and Zizzi are all familiar names and façades for the average Briton strolling down any given high street. These chains have been stalwarts of the British hospitality industry for decades and are the old guard in a rapidly expanding sector – one rich with opportunity.

Côte changed hands last year for a respectable £250 million and is now part of BC Partners' portfolio. In fact, since the beginning of 2015, chains that include Hawskmoor, Byron, PizzaExpress, ASK, Zizzi, Strada, Prezzo, Benito's Hat, Turtle Bay, and The Real Greek have all been sold to new investors. New ventures like Franco Manca have also attracted lofty valuations.

The idea behind the buyouts is simple: private equity firms, encouraged by the restaurants' early success and scope to expand the brand across the country, rush in to invest with minority stakes. According to the latest MCA Eating Out Report - based on pre-Brexit data - the current value of the UK out of home market stands at £86.1 billion for 2016 and is expected to grow by 5.2%. Hotels, pubs and restaurants is the largest sector within the industry, accounting for up to 72% of sales, though sales are only expected to grow by 1.5% this year.



London groups such as pizza chain Franco Manca have been immediate successes for investors. Fulham Shore PLC snapped up the pizza shop in a £27.5million deal last March. David Page, Fulham Shore's chairman, says he was looking for an "inexpensive, value proposition." Indeed, Franco Manca ticks all the boxes; pizzas at the artisan chain retail at around £8 and the simple menu helps keep overheads down. Londoners will attest to the speed with which the pizzeria has expanded. "We usually give it about year or 18 months before we push the button with expansion. We currently have 26 Franco Mancas, growing to 36 in a year." Fulham Shore has also invested in The Real Greek and a small Soho outfit, Bukowski, which is only a few weeks old. "We have two more The Real Greeks on the way, that will make it 12 in total, and one more Bukowski."

When it comes to expansion though, geography is vital. The MCA report suggests a marked difficulty in locating suitable locations for expansion. Outlets like US burger chain Five Guys - as well as UK-founded groups like Barburrito, Leon and Itsu - have been increasing their market share and investing in opportunities outside of London, where high rent prices and shortage of sites has made rapid expansion a challenge.

However, Page warns of the risks of spreading chains to thinly geographically. "We usually expand in London but are now we are looking 50 or 60 miles away to places like Brighton, Guildford and Reading," he explains. "We don't want to spread too quick too far as bigger distances to travel means greater investments to grow the team. If you expand slowly it's better value for the shareholder and investors can stay in control."

Similarly, Brighton-launched Thai Tapas venture Giggling Squid looks set to expand across the country after securing £6.4million from Business Growth Fund (BGF) in 2015. The chain boasts 13 restaurants peppered across the south and south-east and has bypassed London altogether. Plans for outlets in suburbs of the capital are also not out of the question. BGF have previously thrown their weight ▶

behind success stories like Barburrito, Camino and Boost Juice Bars.

"A number of things attracted us to Giggling Squid. We met the husband and wife team in 2013, at the point they had six sites, and we had two years to get to know the business," says Jon Simon, an investor at BGF. "In those two years they did what they promised to us: they doubled the size of the business from six to 12 sites.

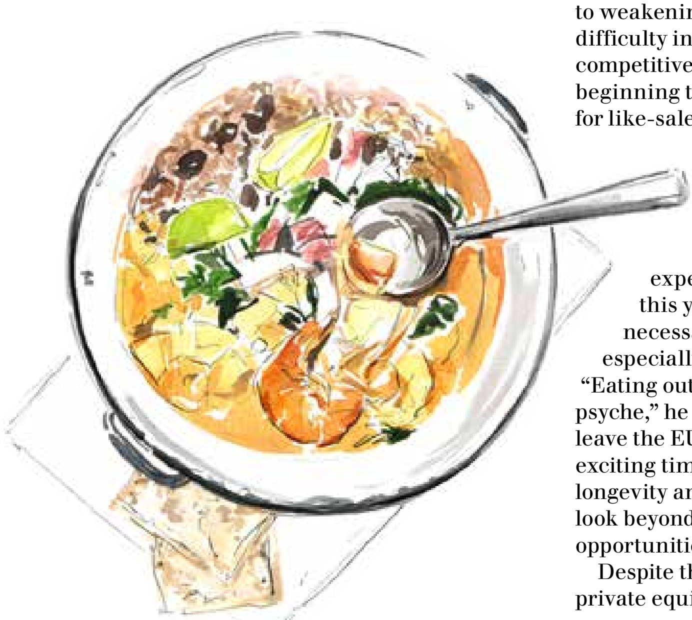
"London is somewhat congested. The market towns where Giggling Squid are certainly competitive but they are a quirky brand and can look at quite unique sites, they don't need those 3,000 square foot boxes for their restaurants to work," he says.

"At BGF we define ourselves as supporting UK-based SMEs that have a defined format and have moved on from early stage ideas. We look at operators with five sites or more and close to £5 million of turnover. We are looking at a growth profile opportunity, not a venture profile opportunity."

It is certainly a competitive environment, although

£86bn
Total value of UK restaurant market

£600m
Total annual revenue of UK restaurant market



there is some concern that the vote for Brexit has dampened appetite somewhat. Turnover growth for the current fiscal year is 2.3%, down from 2.5% in 2015 with outlet growth facing a slowdown to 0.8% from 1%. This modest downturn is attributed to weakening business confidence and increased difficulty in finding suitable sites. "It is extremely competitive. We have seen one or two mature brands beginning to struggle in terms of maintaining like-for like-sales," says BGF's Simon.

The spectre of Brexit looms large over the industry. According to the MCA Eating Out Report, the uncertain climate has hit the fine dining segment hardest of all, with growth expected to fall from 6.7% in 2015 to just 4% this year. Simon doesn't think that Brexit will necessarily have a negative impact on growth, especially with small and medium operators. "Eating out has become a vital part of the national psyche," he says. "I don't see that changing as we leave the EU. We actually think of right now as an exciting time. We want to build companies that have longevity and we look at a longer-term horizon. We look beyond day-to-day movements and see exciting opportunities right now."

Despite these challenges, it appears as though private equity's appetite is not waning. Restaurant

"Expanding slowly is better value for shareholders and investors can stay in control"

chains are an appealing prospect to investors because they are straightforward to expand and generate cash rapidly. Once a formula has been perfected in the early stages it can be rolled out uniformly and efficiently. And it's not just bricks and mortar restaurants that peak investor's interests; pop-ups and food trucks also qualify. But Fulham Shore's Page warns about rapid overexpansion. "We are growing 25% this year and that's plenty. If you try to double in size in a year you lose control."

The UK's out of home market is also extremely diverse. There are an estimated 10,00 street food traders in the UK operating out of food trucks or markets. The total annual revenue of this sector has been estimated at £600million and growing as fast as 20% a year – despite being an incredibly fractured market.

Killer Tomato is a prime example: the burrito eatery started life in the Dalston outpost Street Feast, a London food market, before moving to its first bricks and mortar outpost in Shepherd's Bush in July. "I started the business in December 2013, and by summer 2015 I decided to get out of street food and into bricks and mortar, it took a year to finalise

the transition." says Matt Paice, the founder. "It was tough to sell the idea to investors. It's quite a leap from mobile catering to a restaurant. It's hard for investors to get their heads around something that is a bit differently shaped – there is no equivalent."

Paice eventually came to an independent asset finance company through a consultant, funding his first restaurant that way, as well as with the support of friends and family who bought up small shares of the business. "I found that the amount of money I needed to borrow was awkward, I needed more than what I could get from a bank, but less than what an angel investor was willing to invest," he explains.

Now with the launch successfully out of the way, Paice's long-term vision is to expand to more bricks and mortar sites. And at that stage Killer Tomato will become a prime candidate for private equity companies who can help him roll out rapidly and efficiently.

It is clear that despite the competitive environment and challenges arising from soaring rents in London and beyond, private equity investors who are willing to get creative can still carve out immense opportunities within the restaurant sector. ■