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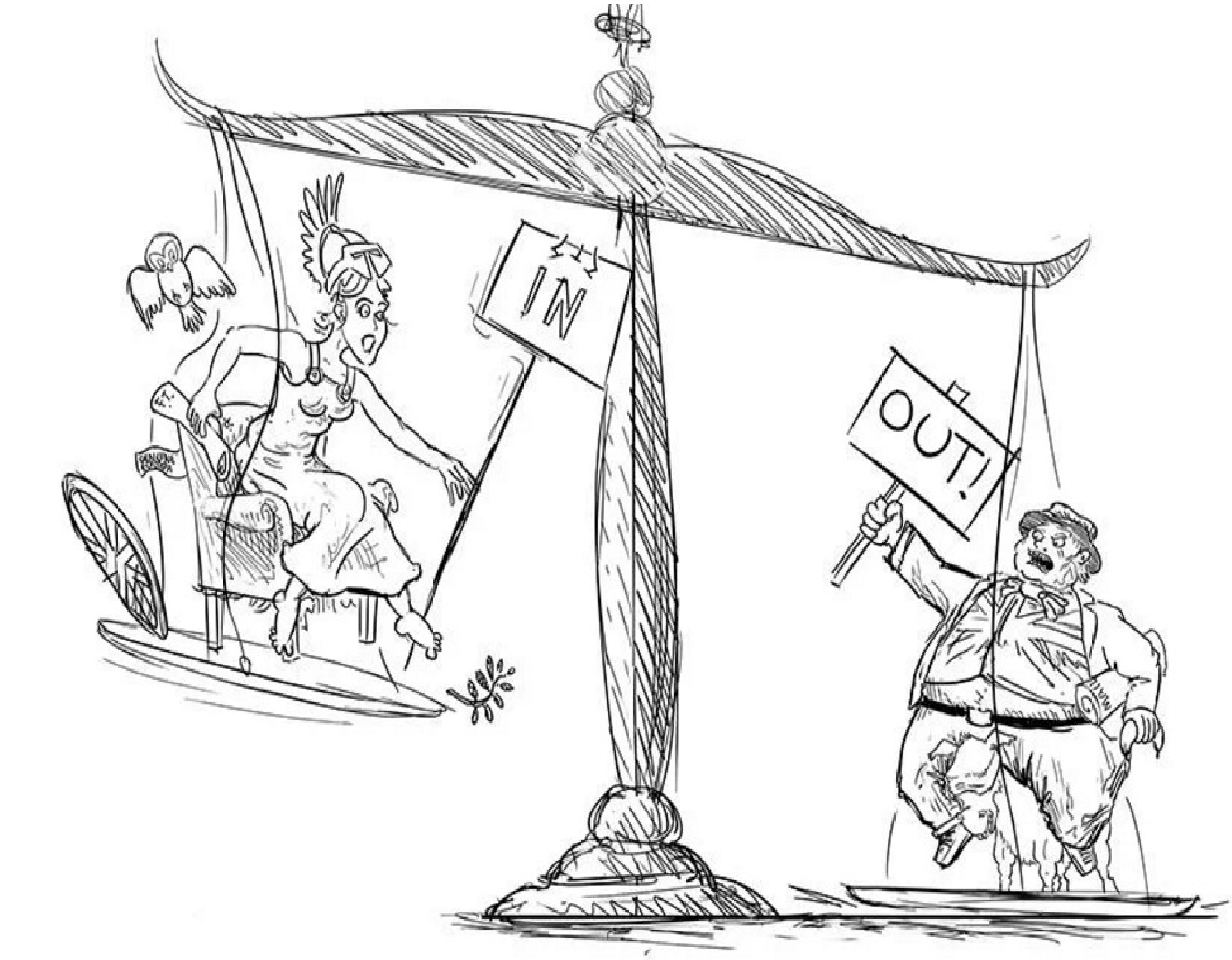

LANGTON'S LEISURE REVIEW

(It's Not All About Brexit)

Consider

Inflation, Innovation, Interest Rates, Theatre, Rising Costs, Evolution, Skills Shortages & much, much more…Langton's free daily newsletter available at www.langtoncapital.co.uk

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February 2017

Contents

Executive Summary

It is fair to say that 2016 marked a crossroads in more ways than one. Against a backdrop of shifting politics, clamouring voices, and heated issues, the UK's licensed on-trade sector finds itself facing substantive headwinds for the first time in years.

Markets face uncertainty and various aspects of operations are in flux.

Operators have thrived and grown over the past few years in an environment of exuberant competition, bold innovation & buoyant spending. This may change.

A falling pound and rising input prices are pushing up costs.

Some are absorbing this into margins and others are passing it onto consumers. For many, inflation is a novel problem. It will manifest as either a one-off adjustment or, perhaps more likely, become an entrenched trend. On a brighter note, a weak pound could boost the staycations market.

This has implications for consumer spend.

Consumption has for so long enabled the leisure sector to go from strength to strength but is now largely fuelled by credit. Consumer caution would likely hit big ticket spend first, but small ticket is not immune. Persistent inflation (within the context of relatively flat real earnings growth) will put the sustainability of leisure sector like-for-like sales gains to the test.

Subtle shifts in central bank rhetoric.

These indicate that the twin monetary policies of quantitative easing and low interest rates that have dominated the past decade may soon gradually wind down. The full impact of this pervasive set of experimental economics has yet to make itself clear.

Tougher conditions favour nimble, quality operators, while marginal sites feel the pain.

Although there are issues the sector must face up to, consumers will always be willing to spend on value-for-money and exciting experiences. Consumer tastes are evolving. People eat when they see fit and are quickly becoming accustomed to the flexibility that delivery provides. Those that can react to evolving trends, while negotiating a less hospitable trading environment, stand to prosper.

Month	Coffer Peach	BoE base rate	10-yr Gilt yield	Temperature from avg.	Features and Events
January	LfLs: 1.9% Total: 5.4% New Space: 3.5%	0.5%	1.545%	+0.9 °C	• MRO legislation ongoing. Eating and drinking out in good health. • Overcapacity issues flagged by Horizons following years of rapid growth. • Food and price deflation ongoing. • Hotel occupancy in mid-to-high 70%s after years of growth. • Unemployment down to 5.1% -- lowest in almost a decade, but wage growth slows. • The Restaurant Group issues cautious pre-close update. Shares fall 18% to 519p. • Mitchells and Butlers shares fall 19% to 327p.
February	LfLs: 0% Total: 3.2% New Space: 3.2%	0.5%	1.499%	+0.2°C	• RBS Six Nations Grand Slam. • Sainsbury's announced £1.3bn acquisition of Home Retail. • David Cameron announces Brexit vote date of 23 June.
March	LfLs: 0.6% Total: 4.9% New Space: 4.3%	0.5%	1.39%	+0.2°C	• England win RBS Six Nations Grand Slam. • ISIL bombings in Brussels, Belgium. • London Underground strike. • Storm Katie causes flight cancellations. • The Restaurant Group's Final Results see shares fall 25.8% to 407.60p
April	LfLs: -0.8% Total: 3.1% New Space: 3.9%	0.5%	1.459%	-0.9°C	• New National Living Wage: workers over 25 paid at least £7.20 per hour. • Tesco sells Giraffe to Boparan Restaurant; Harris + Hoole sold to Caffe Nero. • EU Referendum debate gets underway. • Renewed appetite for regional transactions. • BHS files for administration. • The Restaurant Group trading update sees shares hit a low of 273.6p. • BrewDog's Equity for Punks IV closes, having raised £19m of its £25m target. • Restaurant Group CFO Stephen Critoph resigns. • Tim Bacon passes away. • Eclectic acquires Brighton Pier Co. for £18m; rebrands as Brighton Pier Group.
May	LfLs: -1.4% Total: 2.2% New Space: 3.6%	0.5%	1.332%	+0.9°C	• Leicester City wins (and bookies lose) Premier League. • Introduction of plain packaging for tobacco products. • JD Wetherspoon puts another 33 pubs on the market, total of c100 pubs for sale.
June	LfLs: 1.8% Total: 5.7% New Space: 3.9%	0.5%	0.767%	+0.9°C	• Labour MP Joe Cox dies after being attacked in Birstall • The UK votes to leave the EU by 51.9% to 48.1%. • David Cameron steps down as Prime Minister. • A motion of no-confidence by Labour MPs in Jeremy Corbyn is passed 172-40.

June *(cont.)*					• Graphite Capital acquires New World Trading Company for c£50m. • Efforts to find a buyer for BHS fail. • Sterling collapses & England are knocked out of UEFA Euro 2016 by Iceland. • Mitchells and Butlers shares fall 22% to 224.6p. • Time Out Group IPOs with a market cap of £195m. • Comptoir Group IPOs on AIM with a market cap of £48m.
July	LfLs: 0.3% Total: 4.0% New Space: 3.7%	0.5%	0.686%	+0.2°C	• Wales qualify for UEFA Euro 2016 semi-final after beating Belgium 3-1. • UKIP leader Nigel Farage resigns (again). • The Chilcot Inquiry is released, rejecting Tony Blair's case for 2003 invasion of Iraq. • Angela Eagle announces Labour leadership bid. • Theresa May is announced as new Conservative leader. • Punch Taverns shares hit low of 84p.
August	LfLs: 0.6% Total: 4.2% New Space: 3.6%	0.25%	0.777%	+0.6°C	• Bank of England cuts interest rates to 0.25% - a record low. • Rio Olympics. • The Night Tube launches. • Restaurant Group shares peak at 427.7p but end year at 332.5p. CEO steps down. • BrewDog sets up Equity for Punks USA, which aims to raise $50m.
September	LfLs: 1.8% Total: 5.0% New Space: 3.2%	0.25%	0.742%	+2.0°C	• Draft list publication of new Business Rates (current avg: £16k/pub). • The UK's hottest September day since 1911. 34.4 °C recorded in Gravesend, Kent the hottest day of the year. • Diane James elected as new leader of UKIP. • Jeremy Corbyn is re-elected leader of the Labour party. • Hollywood Bowl Group IPOs with £240m market cap.
October	LfLs: -1.0% Total: 1.9% New Space: 2.9%	0.25%	1.125%	+0.2°C	• PM Theresa May states that she will trigger Article 50 by the end of March 2017. • Diane James quits as UKIP leader after 18 days in the post. Farage back. • The government approves a third runway at Heathrow. • Ed's Easy Diner enters administration. • Ladbrokes and Coral agree to sell 359 sites as part of £2.3bn merger.
November	LfLs: 1.1% Total: 4.1% New Space: 3%	0.25%	1.387%	-1.3°C	• Donald Trump wins US Presidential election. • M&B shares rally to 286p and end year at 250p. Dividend back after 7-year hiatus. Puts 75 units up for sale. • Greene King view of market becoming increasingly cautious. • Innis & Gunn completes oversubscribed crowdfunding with c£2.3m.
December	LfLs: 2.2% Total: 5.4% New Space: 3.2%	0.25%	1.375%	+2.0°C	• Punch Taverns is bid for by Patron Capital Partners and Heineken. Rival expression of interest from Emerald Investment Partners. Shares end the year above 190p. • BrewDog launches its four-year 7.5% bond, the second bond in as many years.

The Sea Change

- ***A moderate trading environment has allowed operators to prosper***
- ***This may have led to an element of over-supply***
- ***The UK on-trade is robust enough to weather most storms, but high growth and marginal operators could come unstuck***

The UK's licensed on-trade prospered post-2009 in an operating environment supported by cheap cash. This boosted both consumer spending and corporate expansion.

These conditions have 1) averted disaster, but 2) propped up uneconomic operators and uneconomic sites, pushing supply onto the market to the point of overcapacity. Coffer Peach data shows a steady 3-4% monthly increase in new space throughout 2016. The law of unintended consequences applies.

Keeping it Simple: Capacity

An example:

If capacity grows by 3%, demand grows by 1%, and CPI grows by 2%, then like-for-likes are flat…

Ed's Easy Diner and The Restaurant Group are two noteworthy examples of operators who have arguably expanded for expansion's sake and have come unstuck in recent times. Langton's view is that there are others out there. Jamie's Italian, for example, is closing six of its 42 UK sites, while 'significant doubts' remain over the viability of Burger and Lobster, which is looking to offload more underperforming sites having ditched its Cardiff and Manchester units.

In 2016, politics dominated. The UK's vote to leave the EU and the election of Republican candidate Donald Trump as the US President Elect are defining events. The UK has seen a radical shift in its political landscape in recent years, with the Labour (2015), Liberal Democrats (2015) Conservative (2016), and UKIP (2016) parties all seeing recent changes in leadership. The Scottish National Referendum also effectively ousted Labour north of the border in 2015.

All the while ongoing supportive Central Bank monetary policy, exemplified by cheap corporate and consumer debt, has served to stoke demand in the licensed on-trade sector despite the macro turbulence. These policies are no substitute for organic growth and demand, however, and it remains to be seen how the marginal restaurant, pub and bar holds up when (and if) interest rates normalise.

Interest Rates, Monetary Policy, and Crowdfunding

- ***Post-crash monetary policies have been necessary, but are unsustainable***
- ***Alternative methods have made it possible for new operators to start up***
- ***While new enterprise is a good thing, crowdfunded companies and the like have yet to navigate a period of retrenchment***
- ***Externally, a weak Pound may bolster the staycation market***

The BoE cut interest rates from 0.5% to 0.25% in August -- a record low and the first cut since 2009. It is worth noting that rates have not actually risen since July 2007, when they went from 5.5% to the lofty heights of 5.75%. During that period of irrational exuberance of 2005-2008, rates were consistently above 5%.

In the present, quantitative easing is alive and well. On 4 August 2016, the MPC decided to increase the stock of purchases of UK government bonds, financed by central bank reserves, by £60bn to £435bn. In late September, the Bank expanded its asset purchasing programme to include corporate bond purchases.

Pumping cash into the system is not a long-term, sustainable solution. As with many other forms of addiction, the longer the abuser depends upon the substance, the more painful the eventual (inevitable) rehabilitation.

Meanwhile, crowdfunding offers a new path to cash. Its newness is revealed by a troubling lack of clarity and regulation. Miracle cures often have side-effects.

Overall, it is a positive development, but more oversight, more due diligence, and a reining in of valuations are required. Regulators have form here and sometimes politicians need a punchbag -- game-changing legislation does get implemented, and often it takes the industry by surprise.

In 2014, bookies got clobbered over Fixed Odds Betting Terminals. Asian gaming stocks recently fell amid rumours of daily ATM limits in Macau. CFD operators have recently been hit both in the UK and Germany after legislation was proposed.

Lotteries are heavily-regulated and some of the crowdfunding valuations we are seeing appear to be based on roughly similar odds. It is surely only a matter of time.

Post 23 June, Sterling weakened appreciably. The British Hospitality Association maintains that this has done little to dissuade UK consumers from holidaying overseas. Indeed, in the short term, there would appear to be some evidence to suggest that consumers have been booking 2017 holidays abroad earlier than usual and have been hoarding cash that would otherwise have been spent elsewhere. Merlin earlier in 2016 commented that, if more visitors were coming to the UK, they certainly weren't going in larger numbers to the group's London attractions.

Over time, however, we would expect a cheaper pound, though it may push up prices domestically, to bolder the staycations market.

Current Trading

- ***The market is becoming more competitive***
- ***An increasing proportion of total sales growth is coming from new space***
- ***Like-for-like sales growth has been stalling***

Excess Capacity, Supply-Push, Saturation – call it what you want…

… But when was the last time you struggled to find a restaurant or coffee shop?

Trading has been 'flat and fierce' -- flat like-for-like growth and fiercely competitive -- despite the consumer's willingness to spend an increasing proportion of disposable income on leisure. There have been notable casualties, including incumbent operators such as Mitchells and Butlers and The Restaurant Group. So far, there has been little evidence of any increased levels of spending resulting from a 'boost' to the staycations market.

Most industry monitors discern total sales rather than margins and do not break out the performance of one sub-group against another. Apples are at risk of being compared with oranges; LfL sales are quoted but it's total sales that bring in the cash, and margin is important in turning sales into profits.

STR data showed diverging fortunes for the UK's hotel industry -- London continues to suffer from oversupply, with occupancy floundering and RevPAR vulnerable, while performance in the regions has been more robust.

More recent data suggests a pick-up in trade. STR noted a good December for hotels, while easyHotel CEO Guy Parsons added in a January 2017 trading update: 'The UK hotel market improved in November and December with RevPAR growing in both months compared with 2015… A similar market improvement has been experienced across much of continental Europe.'

The Picture for Total Sales

Operators are increasingly playing a market share game

Organic LfL growth is a rare luxury; gains are coming from new sites or by taking business from existing competition.

An increasing proportion of on-trade growth has been driven by new openings, arguably lowering the quality of this growth and lending credence to the view of an oversupplied market. Certain operators have expanded beyond their means to capture a larger share of the buoyant UK leisure market.

The **Coffer Peach Business Tracker** shows that, while monthly total sales for the 33-strong cohort of the UK's largest bar and restaurant companies grew by an average 4.09% year-on-year, like-for-likes increased by just 0.59%. This fits in with industry comments of a 'flat and fierce' on-trade market in which incumbents are at times bewildered by relentless innovation and new entrants.

With LfL sales holding stubbornly below an already-low rate of CPI, many resort to discounting. This impacts margins but may flatter LfL sales. The Coffer Peach figures are likely skewed by a poor 2016 for both The Restaurant Group and Mitchells and Butlers.

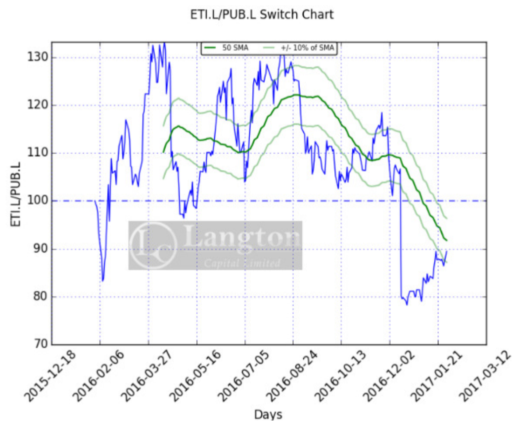
Keeping It Simple: Sales

Sales Increases – Good	*Sales Increases -- Bad*
Full Margin	Discounted
Organic	Delivery
Like-for-like	Cannibalised

The **first quarter of 2016** was characterised by tough trading for incumbents such as the above-named companies. The former spoke of ‘challenges to face’ in the coming year and so it proved, with like-for-like sales down 1.5% in the first 10 weeks of 2016. Ex-CEO Danny Breithaupt might have been talking on behalf of more than just his own company when he warned that ‘in the current environment consistent like-for-like sales increases are likely to be difficult to generate.’ Tim Martin of JD Wetherspoon concurred that trading in the restaurant and pub market was ‘highly competitive’.

Enterprise Inns and Punch Taverns both reported like-for-like sales increases in the early months of the year (ETI LfL income +1.6% for the 19 weeks to 6 February; PUB core LfL EBITDA/pub +1.6% for the 28 weeks to 5 March). These readings serve as only crude proxies for the leased and tenanted pub sector, however, with both companies ring-fencing non-core LfL income.

The **second quarter** saw a continuation of Q1 trends, with M&B and The Restaurant Group suffering and a plethora of newer operators flourishing and expanding (Franco Manca, Loungers, The Breakfast Club, New World Trading Company and American imports such as Five Guys, MOD Pizza etc.). Certain aggressively expanding operators continued merrily to ‘invest’ more and more capital into start-up losses.



Consumer confidence remained subdued ahead of the EU Referendum. In the **third quarter** Tim Martin lambasted the ‘gloomy economic forecasts’ as the group posted buoyant figures and Marstons stated that it had yet to see any impact from Brexit. Meanwhile, Green King struck a more subdued tone with its own cautious trading comments.

Heineken and Patron’s bid for Punch Taverns **fourth quarter** was the standout development towards the end of the year, highlighting the latent value of its property estate and reminding the world that pubs can be viewed as desirable assets. Greene King expressed concern about the wider economy, Brexit, input costs, wage inflation & consumer confidence issues.

Evolution of the Pub Industry

- ***Market Rent Only is forcing innovation in the tenanted pub sector***
- ***UK beer remains overtaxed, but recent beer duty freezes have helped business***
- ***Small and growing brewers are opening bars, highlighting the strength of the vertically-integrated model***

MRO option has accelerated the evolution of business models

The implementation of Market Rent Only is ongoing and complex. It has forced Enterprise Inns and Punch Taverns to speed up innovation and to radically alter their operating structures. Although it remains unclear just what proportion of tenants will end up applying for the option, an impact has already been registered by the industry.

Heineken and Patron's bid for Punch Taverns, whose shares have for so long traded at a material discount to book value, perhaps reminded the market that freehold pubs should be considered a desirable asset. Observers might now be regarding the UK's two largest pubcos in a different light, with further opportunistic bids not out of the question.

This move has not only shaken up the market, but is another step in a trend (indeed, reversion) towards the vertically-integrated operating model. Again, we are reminded of the unintended consequences and influences of external regulation and policies -- this time of The Supply of Beer Tie Orders of 1989.

Beer Duty Freeze and legislation driving secular shift towards Craft Beer

Between 2008 and 2013, the beer duty escalator increased beer duty automatically by 2% above inflation each year, impacting the beer and pub industry. Tax on beer rose by over 40% with over a third of the price of a pint going straight to the taxman. Brewers and publicans suffered six above-inflation duty increases in five years.

This changed with the one penny tax cut in Budget 2013. Following budgets recognised the unique economic and social value of beer and pubs with an unprecedented hat-trick of beer duty cuts, which were consolidated by a freeze in the duty rate in 2016. Beer price increases in pubs are at their lowest in percentage terms since the 1980s.

Small breweries are thriving under the current conditions and the UK's vibrant craft beer industry is now a source of great pride and creativity. The scale of the craft beer explosion in the UK does suggest that there will eventually be a shakeout. Buoyant trading and growth may well be part of a permanent, structural shift in UK consumption habits, but the sector is vulnerable to sustained increases in hops prices.

However, after years of above inflation duty increases, beer is still overtaxed. UK beer duty is almost 10 times more onerous than similar countries such as Germany and averages about 52p per pint of 5% ABV. Further tax cuts in this area would provide welcome relief to an industry facing various headwinds, with similar measures having proven to be a valuable catalyst in the recent past.

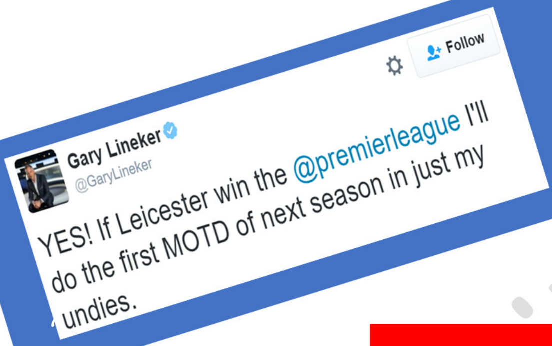
A Most Surprising Year

'I do not think it would be right for me to try to be the captain that steers our country to its next destination'

David Cameron, ex-Prime Minister

'EU's finished, EU's dead.'

Nigel Farage, ex- leader of UKIP


Gary Lineker @GaryLineker
Follow
YES! If Leicester win the @premierleague I'll do the first MOTD of next season in just my undies.

'You're not going to be able to insult your way to the presidency.'

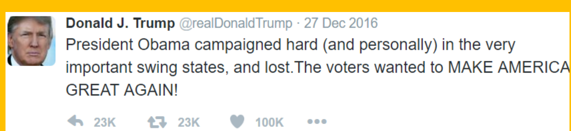
12/15/15 Jeb Bush to fellow Presidential candidate Donald Trump

'Just watched Jeb's ad where he desperately needed mommy to help him. Jeb --- mom can't help you with ISIS, the Chinese or with Putin.'

23/01/16 President Elect Donald Trump

'I continue to believe Mr. Trump will not be President.'

Former US President Barack Obama


Donald J. Trump @realDonaldTrump · 27 Dec 2016
President Obama campaigned hard (and personally) in the very important swing states, and lost.The voters wanted to MAKE AMERICA GREAT AGAIN!
23K 23K 100K

2017: So, Where Are We Now?

Introduction

- ***Inflation is back but its full impact has yet to be discerned***
- ***Consumers have been spending more on Leisure***
- ***Some of this consumer spend might get diverted because of rising prices***

Inflation is working its way back into the system. This will either feed through as a one-off currency adjustment (driven by the pound's re-rating) or could spark a longer period of self-sustaining inflation.

To do the former, someone (either labour or capital) must take the hit. If the latter, operators who have flourished in the historically low interest rate environment of the past eight years may find themselves facing their first real test sooner than they would have liked.

Against an admittedly worsening backdrop, the UK consumer has been showing and continues to show an increasing desire to eat and drink out, seeking value, provenance and an element of theatre. Visa's UK Consumer Spending Index shows the level of consumer spend on leisure activities substantially outperforming total spend in recent times.

Visa UK Consumer Spending Index 2016

Month	Total Consumer Spending (YoY % growth)	Hotels, Bars & Restaurants (YoY % growth)
January	2.7	9.7
February	2.2	13.6
March	2.3	5.3
April	2.5	6.6
May	0.8	6.7
June	0.9	3.4
July	1.6	8.9
August	0.1	4.3
September	2.4	6.0
October	2.5	9.0
November	3.2	2.0
December	2.6	7.3

Mark Gregory of the EY ITEM Club suggests that consumer spend, which has been so crucial to headline figures in the past few years, might come in for a period of significant retrenchment. Weaker sterling will serve as a catalyst in the re-balancing of the UK economy away from an over-dependence on consumer spend back towards exporting. It will be interesting to see who steps up to work in unglamorous, essential industrial professions and what this might mean for the proportion of adults going to university.

A move from 2.8% growth to 0.4% has implications for the capacity for new units…

Those that have been growing to stand still will find little solace in higher rents, rates, and wages.

The above table suggests unsustainable growth in hotels, bars, and restaurants. The EY ITEM Club concurs, and forecasts consumer spending to fall from 2.8% in 2016, to 1.7% in 2017, before falling to 0.4% in 2018 'as household incomes are squeezed'.

The Storm Clouds

- ***There is a greater sense of uncertainty in today's markets***
- ***Wage increases might push up costs but operators will be able to budget***
- ***Terror attacks continue to affect tourism***

Political events of the past year (including the US election and EU referendum) point to a sea change in political sentiment and arguably put a degree of pressure on the Central Bank-dominated monetary strategies of the past decade.

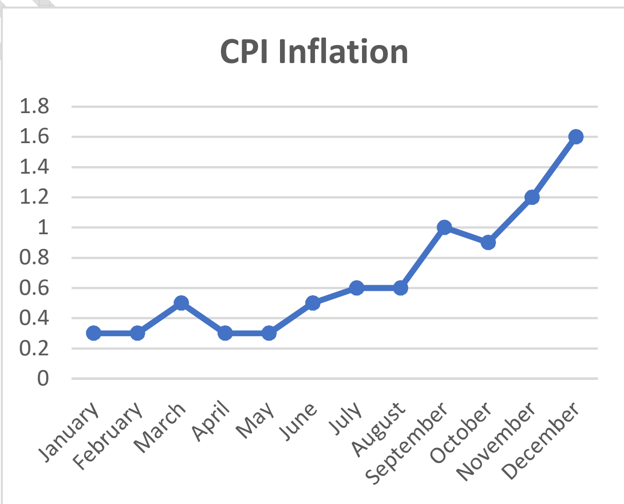
Fiscal stimuli & borrowing is associated with higher interest rates for e.g. lending momentum to a latent trend of rising interest rates. When coupled with government initiatives such as increases to the National Minimum and Living wages, the Apprenticeship Levy, and the business rate revaluation, this raises the prospect of materially higher cost bases in the industry over the next couple of years.

> Higher interest rates, rising input prices, higher rents, the National Minimum and Living Wages, overcapacity…

There are a lot of issues for operators to bear in mind in the coming years.

The prospect of a squeeze on consumer income is real, should wages fail to keep up with inflation. It remains to be seen whether the current bout of rising prices is a one-off adjustment instigated by the fall in value of sterling and consequent rises in import costs or something more entrenched. Should consumers decide to pull back on spending, this might first manifest itself in slacker demand for big ticket items.

Travel remains susceptible to terror threats. The rise of strong leaders (Trump, Putin, Erdogan) enhance the potential for heightened political rhetoric and grandstanding -- even before his inauguration as US President, Donald Trump was sending warning shots to China and alluding to the possibility of a trade war.



This change in political tone is typified by a renewed emphasis in some quarters on nation state diplomacy (and unilateral trade agreements as opposed to trade blocs) and the perceived 'retreat of globalisation'.

The marginal operator is at risk, as are outdated brands with high prices guarding high margins. Those who have opened sites in the wrong places might also have their previously hidden strategic errors exposed.

Some of these headwinds have already been factored into stock valuations. We attempt to ascertain risks to the sector in the years ahead and what it might mean for businesses going forward.

Consumers' Personal Balance Sheets

- ***UK house prices remain at historically high levels***
- ***House price growth has shown some signs of slowing, particularly in London***
- ***The Bank is alert to a 'step change' in consumers' use of credit, which must be viewed in anticipation of rising rates***

The link between wealth and spending is contested but the consensus is that the pair are positively correlated. UK house prices continue to march upwards and the standardised average price appreciated by 6.7% over the course of the year, ending December at £222,484, per Halifax. Nationwide has a figure of 4.5% annual growth to £205,988. Although valuations are toppy as multiples of median wages, the situation is not approaching the levels of the financial crash when houses were used as piggy banks. That said, there was scope in 2008 for interest rates to fall – that is definitively not the case in 2017.

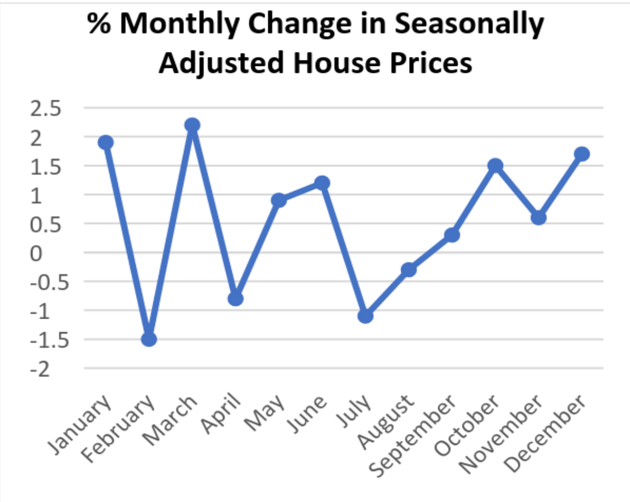


Figure 1 Halifax House Price Index

London's period of outperformance appears to be ending, however, with house price growth in the capital lower than the UK average for the first time since 2008.

Slower economic growth, pressure on employment and a squeeze on disposable income will most likely dampen house price growth in 2017. A small gain in house prices of 2-3% is a reasonable expectation for the coming year, however, the Bank of England stated the outlook for UK house prices remained 'highly uncertain'.

Alongside the rise in UK house prices, the Bank of England's recent Stability Report notes a steady increase in customer credit. The overall ratio of household debt to income was 133% in the second quarter of 2016.

Increasing consumer credit makes sense when interest rates are low...

... But rising rates would bring household finances into much sharper focus.

British households have c£66.2bn of credit card debt outstanding, up by £571m in November alone, and overall unsecured consumer credit grew by 10.5% in the year to October. Mark Carney stated that BoE will 'be keeping a close eye on consumer spending' as 'consumer borrowing has accelerated quickly'.

Should the UK be compelled to raise interest rates, say, in response to the US doing so in anticipation of Donald Trump's expected fiscal stimuli, otherwise benign household debt could sharply become a problem.

Uncertainty

- ***The EU referendum means trading relationships might have to be redefined***
- ***This sense of flux is amplified by global events such as the election of President Trump***
- ***The world faces an uncertain outlook, which could impact business confidence***

The next few years signal a period of uncertainty for the UK economy driven by a variety of factors; lengthy Brexit negotiations give rise to legislative, political and trade deal risk. That doesn't sound too bad if you say it quickly but it's also true that years of uncertainty may not be helpful.

The recent Supreme Court pronouncement that any Brexit ruling must go through Parliament and that MPs are entitled to vote on Article 50 makes the picture a little clearer. If the House of Lords blocks the move, a General Election would be required. Should it pass, the Government has already made it clear that there will be 'no running commentary' on proceedings with European officials.

It'll all be over by Christmas…

The CETA (Canada - EU trade deal) took seven years to finalise, with Deloitte remarking 'such free trade deals typically take between five and seven years to negotiate, with a further year for ratification.

In this event, it is reasonable to assume Brexit by March 2019 and a General Election in May 2020, however this is far from certain. It seems likely that inflation and interest rates will rise from recent historic lows, in the meantime.

UK trade talks?

Europe and the rest of the world have more pressing concerns…

This has systemic implications. How does the UK manage down the asset bubbles and over-supply that are side-effects of monetary policies desperately enacted to support the economy post-2009? The fate of EU nationals who comprise so much of the UK Leisure workforce is also a source of great uncertainty, although their cause is being campaigned for admirably by trade bodies.

Brexit and the election of Trump in 2016 spearheaded a shift away from globalisation and towards sovereignty. These goals are not binary and perhaps in the coming years a balance between the two might be struck.

With key general elections coming from the Netherlands (March 2017), France (April 2017), Germany (September 2017) and Italy (at any point before March 2018), political uncertainty in Europe is the only certainty. Geert Wilders (Netherlands), Marine Le Pen (France) and Beppe Grillo (Italy), are riding the wave of anti-immigration sentiment within Europe and are all gaining traction in their respective nations.

The domestic political concerns of these nations take precedence over renegotiating trade agreements with the UK. Protracted, stalling Brexit talks would corrode long-term customer confidence. One notable effect of the EU referendum has been the rerating of Sterling and the subsequent increases in input and commodity prices, with some operators choosing to absorb these costs and others opting to pass them on to the consumer.

The UK has been subjected to an ill-tempered, ill-informed and divisive referendum that has arguably polarised opinion and sentiment. Immigration now appears to be a central variable in what will most likely be multi-year negotiations with the European Union. It is worth bearing in mind that a large minority of the on-trade's workforce comes from the EU and it is in the industry's interests for this to continue.

According to the Oxford University think tank Migration Observatory there are 442,000 EU nationals working in the UK restaurant and Bar industry (about 15% of the industry workforce). As many as 96% of these workers would not qualify for work visa requirements under current, hard Brexit proposals.

This casts a shadow over the industry and the BBPA is already drawing its battle lines. Margin pressures and rising labour costs, if combined with reduced investment, could lead to like-for-like pain two or three years down the road.

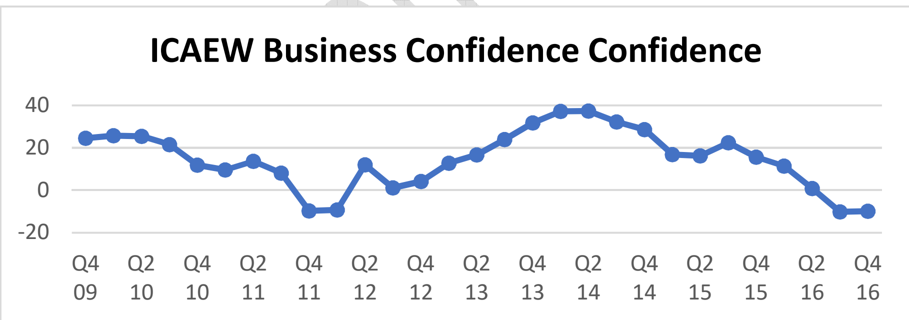
Nissan says its continued investment in the UK depends upon the terms of Brexit. HSBC, Goldman Sachs, and UBS have all reported that they might move thousands of bankers from the capital to mainland Europe. Officials in Frankfurt have met with 50 international banks to discuss how they might relocate some or all their operations out of London. This exodus may continue if uncertainty looms over conditions of a British exit of the EU.

Business Confidence

- ***The ICAEW's Business Confidence Index describes a decline in confidence***
- ***Falling confidence impacts capex, acquisitions, and expansion***
- ***Good, strong brands can weather a slowdown; marginal operators will struggle***

The ICAEW's Business Confidence Index for Q4 2016 indicates that, while business confidence 'marginally' improved towards the end of last year, it remains depressed. This is reflected in lower business investment and reductions in the outlook for sales and profitability.

Recent US restaurant company results back up the ICAEW's findings, with Chipotle, Ruby Tuesday and Kona Grill all recently reporting substantial reductions in sales in their latest results. The previously mentioned examples of Jamie's Italian, Burger & Lobster, and Ed's Easy Diner have closed sites due to a 'tough market'; it is reasonable to believe there could be some read across to the UK from the US.



It is likely that a structural supply-demand imbalance is developing in the UK (and has already developed in the US). There is still plenty of upside to be had by good concepts which offer new experiences and value-for-money for consumers, however.

Departure from some combination of the EU, the single market and the customs union could knock consumer and business confidence. The marginal operator is at risk, as are outdated brands with high prices and high margins. Those who have opened sites in the wrong places might also have their previously hidden strategic errors exposed.

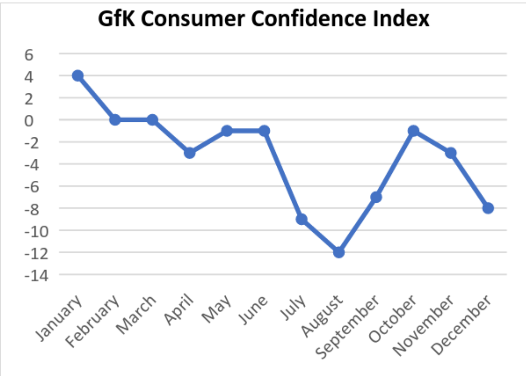
> *'At some point trade will dampen – you will see no reduction in the top one or two but you'll see huge reductions in the bottom one or two.'*

Consumer Confidence & Behaviour

- ***Consumer confidence rallied post-Brexit before retrenching at low levels***
- ***Falling business confidence can impact consumer confidence***
- ***Inflation, if sustained, could act as a drag on disposable income***
- ***This could increase competition for customers in the on-trade***

Sustaining consumer confidence will be key to the continued success of the UK's eating and drinking out market. Confidence was subdued early in 2016, as the European Referendum weighed on the consumer's mind.

This weight appeared to be lifted in the second half of the year. The picture here has proven resilient since the vote, and has resulted in a 0.4% upward revision of the economic outlook for the UK by the IMF to 1.5% in 2017. The process of exiting the European Union has in truth not yet started, however.

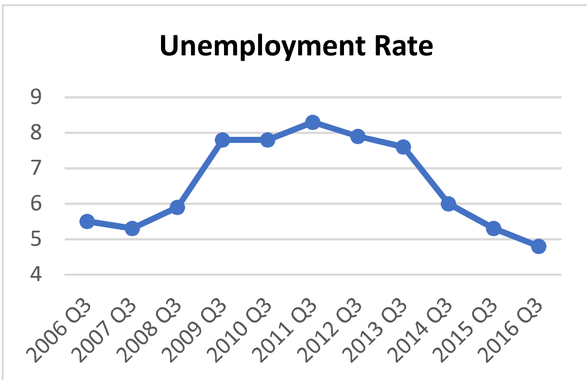


In the meantime, unemployment is low and wage growth, which has for so long lagged house price and stock market inflation, is set to accelerate with the National Living and Minimum Wage initiatives.

We would argue, however, that this is taking money out of one hand and putting it in the other, as company money that could be spent on capex and investment is being used to fund this wage growth.

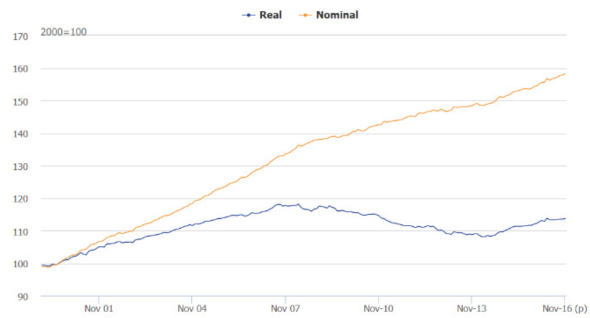
Earnings and Unemployment

- ***Despite an uncertain outlook, employment remains at record levels***
- ***Wage growth has been muted, but consumers are spending more on leisure***
- ***Scope for true LfL growth is shrinking***



Jobless levels have remained at good levels throughout 2016, however, gentle consumer wage growth since 2000 has failed to keep up with rising living cost for many UK consumers.

Great Britain, January 2000 to November 2016



Source: Office for National Statistics, Monthly Wages and Salaries Survey (MWSS)

Unemployment is at its lowest level in a decade and has fully recovered from the highs witnessed in the aftermath of the credit crunch. Between June to August and September to November 2016, there were 23.25 million people working full-time (+209,000 year-on-year), with 8.55 million people working part-time (+86,000 year-on-year). The employment rate was steady at a healthy 74.5%.

Data from the ONS' labour market statistics time series dataset indicates that Average Weekly Earnings in the UK have grown by a compound 3.08% since 2000 (this does not account for inflation). Visa's monthly UK Consumer Spending Index, meanwhile, regularly shows year-on-year growth in the hotels, restaurants, and bars sector far ahead of total spend growth.

Keeping It Simple: Economics

Langton's Economic Equation:

Work harder + work longer + have > 2 kids + immigration + technical improvements = be wealthier

If you don't want to do 1 or 2 or 3 and you reject 4 and there is no 5 = artificial wealth (a.k.a. inflation)

The Outlook

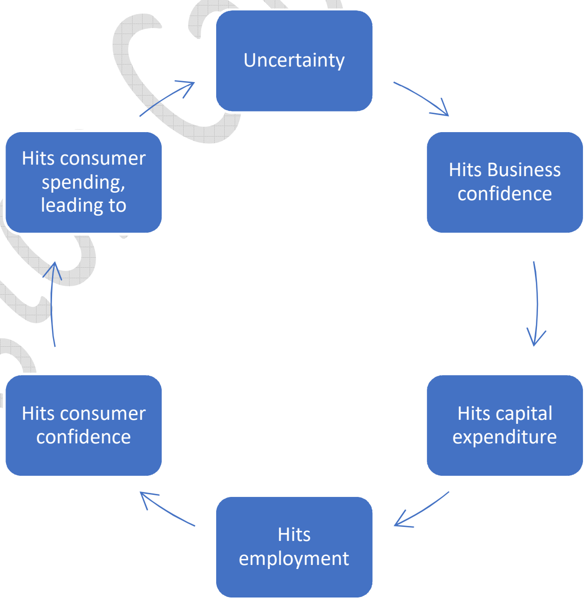
Issues to look out for

The Usual Suspects (and some new ones, too)
Labour – cost and availability
Over-supply, property costs, non-economic units
Inflation, commodity costs, the value of sterling
Stealth taxes and red tape. Business rates, levies, etc. Planning permission.
Enforced evolution -- Market Rent Only option (MRO)
Natural evolution – consolidation, delivery, online, 'experiential economy'
Business and consumer confidence as Brexit progresses
Consumer confidence – no job losses yet but Brexit uncertainty. Also impacts 'desire'
Consumer income – jobs, unsecured debt, inflation impact on disposable income
External events – sports, weather, elections, terror risk, politics

Conclusion

In today's market, the only certainty is uncertainty.

That is not to say businesses can't prosper, but a lack of visibility engenders a mood of caution, whose symptoms can manifest in business as moderating capital expenditure.



This in turn can hit employment.

Companies pull up the drawbridges and wait for friendlier climes. More uncertainty in the jobs market causes consumers to echo this caution and rein in spending, reinforcing existing trends. Although a range of outcomes is possible, analysis suggest that the above might prove to be the case at least in the medium term as the UK works its way through the implications and realities of leaving the EU.

A degree of macro-economic normalisation is anticipated.

The era of quantitative easing and historically low interest rates is becoming harder to justify as each passing year takes us further away from the extraordinary set of circumstances faced by global financial markets in 2008 and 2009.

Asset bubbles need addressing.

Between then and now, unprecedented (and necessary) monetary policies have generated asset bubbles in parts of equity markets, bond markets, and housing markets. The first allowed equity investors to profit while swathes of real society stagnated. The middle has been essentially insured by central banks that have provided a floor by hoovering up debt. The last has ensured a significant proportion of the population has had to spend an increasing share of their stagnating incomes on rent.

Pressure on disposable incomes shows no signs of abating.

Price rises facing businesses will (and already are) being passed onto the consumer. This trend could persist for much of the coming year. Big ticket purchases may bear the initial brunt but small ticket will not be immune. The staycations market may be bolstered – over time – by a weaker Pound but, in the short term, there are signs that more Brits than ever are saving to holiday abroad.

Nobody said it was easy.

Despite clouds on the horizon, the UK's on-trade remains a source of strength, jobs, and innovation to the wider economy. Tough times lie ahead, though. In the immortal words of Coldplay, 'Nobody said it was easy / No-one ever said it would be this hard.' Cost pressures and cautious spending may well drive an industry shake-out at some point, but quality operators should be robust enough to navigate treacherous waters so long as their proposition remains good value to the consumer.

Leisure remains an aspirational product.

The consumer wants to spend, and will continue to do so, but only with operators offering them a memorable experience at a reasonable price. Those who can remain relevant, innovative, and forward-thinking in a digital age will continue to prosper.

Appendix – Recent Flash Notes

24 Jan 2017

THE OFFER: REMAINING RELEVANT:

Leisure companies compete with each other. But they also have to battle Facebook, Netflix etc. for share of face & the leisure pound…

Summary:

Flinging pints at vertical drinkers is no longer enough. It maybe never was but, now, consumers have more choice than they have ever had before. Remaining relevant is key.

Complacency is (still) not an option:

Staying relevant:

- Food, families, good service, value for money etc. are all still necessary
- But are they sufficient if an operator is to prosper?
- Possibly. Provenance, ethical sourcing etc. remain valid but be adaptable
- Watch out for left field, don't get stuck in a time warp, watch younger customers
- Worry if they aren't in the pub. Because they are somewhere, doing something

Major trends:

- Outbound delivery has arrived. It may flatter sales for some but will hurt margins.
- Inbound delivery may grow as a 'thing'. Non-food pubs could offer outsiders' grub.
- Eyeball 'roo-boxes'. Could you use them? Inbound or outbound? Or both?

Demographics:

- Evolution may be 'non-threatening' – but it's likely dramatic change in slow-motion.

- ‘The experiential generation’ sounds like mumbo jumbo but it is important

What it means:

- People have got enough socks, pencil sharpeners & carbohydrates
- They can have 3,000 calories & a bottle of vodka for a tenner
- But they’d prefer a different kind of buzz

- The Dog & Duck may not want a trampoline park but be pro-active, do something
- Ping pong, bowling lanes, foot-golf (yes, really), theatre, escape rooms, VR, pool tables
- Cinema can do F&B, F&B can do cinema etc. etc.

Reality check:

- Shoreditch doesn’t equal Sheffield, Brixton’s not Bridlington.
- Good food, good drink, a bit of footie etc. will remain a core function.
- But many, many pubs have 1st floor or outside space. And they’re not busy 24/7.
- Perhaps think of this as an opportunity as well as a threat.
- It’s all high-energy but come on guys, who said life would be easy.
- After all, there aren’t many lazy, self-made millionaires in the boneyard

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18 Jan 2017

SUPPLY PUSH: BUILD IT AND THEY WILL COME*…

Low interest rates, easy money, asset bubbles, over-building etc. Is it déjà vu all over again…?

Supply Push: Build it and they will come*…

New capacity meets slack demand, headwinds etc.

The conundrum:

- The sum of the micro parts may not equal the macro whole
- Translation: What's good for individual operators may not benefit the total market
- Further translation: Adding marginal units may help a company but contribute to over-supply
- Conclusion: New entrants (vibrant, relevant, cheap) may prosper
- Downside: Lumbering, entitled & increasingly irrelevant incumbents may not

Problem exacerbated by…

- Low interest rates, slack banks (possibly overseas) & 'willing' consumers
- Customers are bolstering their spending by taking on more debt

All Dressed Up & Nowhere To Go

Symptoms:

- New builds, F&B-heavy shopping malls etc. Potential for White Elephants elevated
- Rising rents, scarce labour, chef shortages. Costs therefore rise.
- Market (and companies) feature rising total revenues, struggling Like-for-Likes

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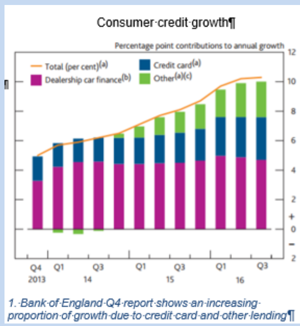
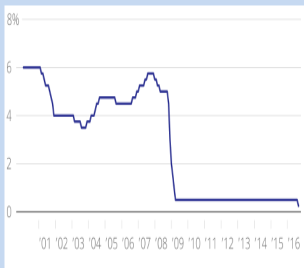
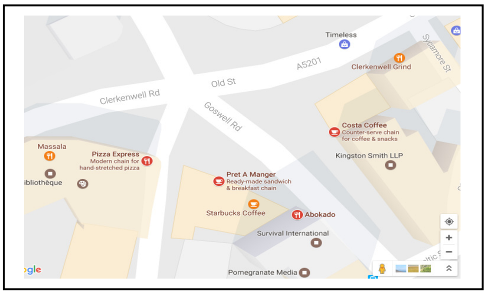
Household Debt Rising



UK Base Rates 2000-2017



New build. Hang on a minute…



- When could you last <u>not</u> find a coffee shop? Or a burger shack, pizzeria etc.?
- So, is cannibalisation a problem? For the industry, quite probably.
- But individual operators say don't see industry-wide cannibalisation as their problem
- To succeed, you need a loser, a patsy. If you can't see who it is, it may be you…

So, what's the answer?

- Sell what your customers want to buy (Dave Potts: Morrison's)
- Successful trading is simple – but it's not easy (Warren Buffett: Berkshire Hathaway)
- Don't be greedy, lazy or stupid (Anon: Langton Capital)
- Only back the winners (Slippery Pete: Beverley Racecourse)

Demand pull; good. Supply push, not so much…

- Be careful before seeking to 'educate' your customer
- Even disruptive models ultimately need to generate income
- Supply push is OK in IT (here's the answer, what's the problem?), less so on the High Street

Said the idiot to the lamppost…

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Langton
Capital Limited

17 Jan 2017

Value wins if costs rise

The prospect of a real income squeeze drives consumer's search for value

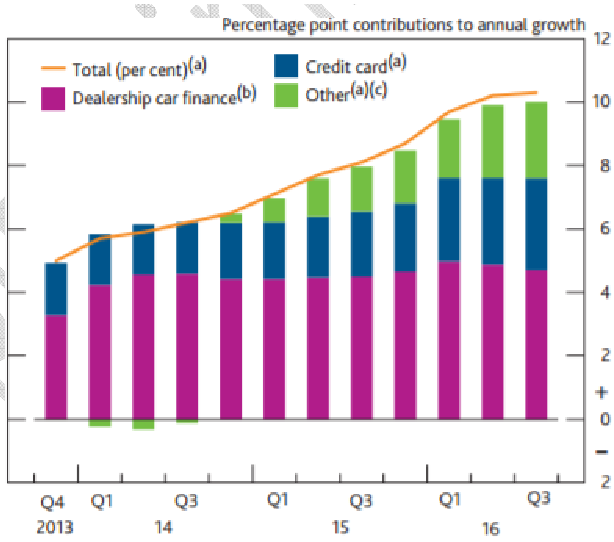
Summary:

Gentle consumer wage growth since 2000 has failed to keep up with rising living costs for many UK consumers, who are increasingly having to fund their lifestyle on unsecured credit. This shift in the quality of consumer spend could lead to a correction and subsequent sorting of the wheat from the chaff.

Non-economic growth in the on-trade?

- Langton has written recently on supply push in the on-trade (here, here, and here).
- Monetary policy and consumer spending growth has supported the industry and has kept trading buoyant.
- Rising consumer leisure spend is being increasingly funded by unsecured debt, which is itself made possible by historically low rates.
- This suggests a growing proportion of today's like-for-like growth is vulnerable to rising interest rates.

Consumer credit growth



2. Bank of England Q4 report shows an increasing proportion of growth due to credit card and other lending

Average Weekly Earnings, Consumer Costs, and Bank Warnings:

- Data from the ONS' Labour Market Statistics time series dataset indicates that Average Weekly Earnings in the UK have grown by a compound 3.08% since 2000.
- Visa's monthly UK Consumer Spending Index, meanwhile, regularly shows year-on-year growth in the hotels, restaurants, and bars sector of as much as 9%.
- Other big consumer costs have also been rising in excess of wage growth, including private rents (+2.2% CAGR), while mortgage rates will not always remain at such forgiving levels.

Yes there are headwinds, but quality shines through:

3 UK consumers have been spending an increasing amount of disposable income on the 'experience sector'

- Incoming cost pressures have been well-flagged by suppliers and the on-trade.
- Inflation can be hard to keep a lid on. Disposable incomes may fall in real terms.
- Rising interest rates would also put pressure on stretched household finances and growing unsecured debt.
- The winners in such a scenario will be operators who offer value-for-money and a sense of experience.

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12 Jan 2017

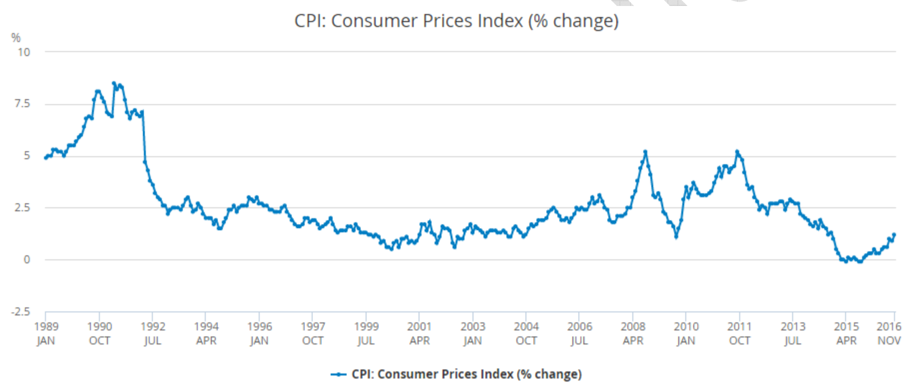
INFLATION: FRIEND OR FOE?

After years in the shadows, inflation may be making something of a come-back. Here we consider whether that is altogether bad news:

Hello Inflation My Old Friend…

Background:

- Many consumers have little or no first-hand experience of inflation
- The two 5% spikes in 2008 and 2011 were ‘aberrations’
- We were in short pants (or not born) in the 20% plus days of the 1970s
- Nobody’s suggesting we’re going back there but there’s a rumble in the price jungle



Source: ONS

RIP deflation – here’s a Brave New World. Velcro vs Teflon:

- Deflation’s not a thing anymore
- So remember, when costs fall, you cut prices slowly (and not by much)
- When costs rise, you pass then on (plus a bit) like a hot spud

Only the Lonely – AKA Bad Inflation:

- If only your costs rise, you may not be able to pass higher costs on
- Unsympathetic customers, whether B2B or B2C, may shun your products
- Examples may include single commodity price rises, single currency issues
- Or shortages due to remote events such as trebling of hard drive prices post 2011 Thai floods

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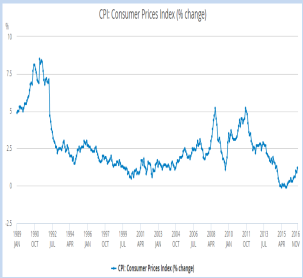

Unconscious Collusion – AKA Not Bad Inflation (don't say 'Good'):

- If cost rises are widely spread…
- If they are well-flagged…
- If they are universally 'understood'…
- If they are not the 'fault' of greedy suppliers…
- Then they may be passed on and everyone, accidentally, will make more money

Where are we now?

- It will be interesting to see if Tesco etc. 'reluctantly' accede to producer price demands
- We believe they will because, if not now, then when?
- They will seek (but perhaps fail) to maintain their 'consumer champion' status
- Pubs, bars & restaurants will put through price rises Q1
- We think these will see % margins fall but will materially widen cash margins
- Now that's fortuitous, isn't it?

All Friends Now?

Major beneficiaries:

- Low margin, high volume operators should benefit most
- However, remember these companies are most negatively exposed if rises don't stick
- But they will stick. Operators will bank profits and thank their lucky stars
- Or possibly they will pat themselves on the back & trumpet their skill, erudition

*Words & phrases to watch out for:

- Don't refer to 'enhanced margins'. 'price gouging', 'take advantage' or 'good inflation'.
- Do use the words 'reluctantly', 'restraint' and 'after many years'

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11 Jan 2017

US RESTAURANTS HIT SPEED BUMP. ANY LESSONS FOR THE UK?

US restaurants are bemoaning LfL sales decreases. 'Too many restaurants, too few customers' they say. Sound familiar?

Summary:

Opening more and more units is great. And then it isn't. The US has been suffering from LfL declines for some time. There may be a lesson to be learned this side of the pond.

Restaurants in US hit bump, any UK read-across?

Gloomy comments Stateside:

- 4 Jan: NPD Group says 'a restaurant industry that struggled with weak sales and traffic in 2016 shouldn't expect much improvement in 2017.'
- 4 Jan: NPD 'expects restaurant industry traffic to remain stalled in 2017'. It sees a shift from dine-in to quick-service
- 4 Jan: NPD says there are 'more restaurants than visitors.'
- 6 Jan: Nation's Restaurant News says Netflix growth is increasing competition for customers' time & money.

Company comments in US:

- 6 Jan: Ruby Tuesday says Q2 (to Dec) LfL sales down by 4.1%. CEO says 'results of Q2 were disappointing.'
- 11 Jan: Chipotle expects LfL sales to fall 4.8% in Q4. This would still mark best for 5 quarters. Admittedly it was hit by an E.coli outbreak in Oct 15
- 11 Jan: Chipotle LfL sales down 15% on 2yrs ago.
- 11 Jan: Shake Shack is increasing prices ahead of 'wage hikes'

- 11 Jan: Kona Grill reports Q4 LfL sales down 4.1%. Says sales were 'weaker than anticipated' & blames 'weak retail traffic, inclement weather & influx of new competition'.

Above in context:

- Some consistency here
- Companies spinning it with 'as you know, things are currently very tough…'
- But did we? Really?

Shake Shack Hikes Burger Prices to Increase Worker Wages

Implications for UK:

- Overcapacity, price-gouging, mediocre product (featuring high-rent units, costly labour & a less-than-relevant offer) will pay-back negatively in any kind of slowdown
- We should look more critically at '0 to 60' superstars: Ed's, Bill's, Five Guys, Strada etc.
- Consider RTN's volte face, JDW's pub sales, slowed expansion, Jamie's closing 6 etc.
- Expensive, entitled offers may fall foul of a more discerning (a.k.a. penny-pinching) consumer
- This is still a growth industry - there's a critical difference between 'simple' and 'easy'
- Saying 'back winners' is simple. But it's not easy

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9 Dec 2016

CROWDFUNDING IN THE CROSSHAIRS:

FOBTs, ATM limits, Spread betting legislation: Risk re Crowdfunding

Summary:

Crowdfunding aims to 'democratise' fund-raising. Critics suggest, however, that it is a thinly-regulated industry, raising money from gullible individuals at unrealistic prices.

When Risks Become Real:

The fallacy of '5 sigma' events:

- Q: If 'five sigma' events should only happen 1 in 3.5m times, why are they so frequent?
- A: Because there is no normal distribution.
- A: And we suffer from over-optimism, wilful blind spots, call it what you will.
- A: And regulators, politicians etc. may interfere, they may not have read the script.
- A: And there may be a lemming-like belief that the worst can never happen.

Yet it not-infrequently does - cases below happened just this week in just this sector:

- CFD (betting) operators were hit Monday when legislation was proposed in the UK

- They were clobbered again when similar moves kicked off in Germany
- UK domestic betting companies fell when FOBT restrictions were proposed
- Asian gaming stocks fell when ATM daily limits in Macau were rumoured


UK watchdog clamps down on spread-betting companies

FCA proposes better risk warnings and limits to leverage offered by brokers

© Bloomberg

Learnings:

- Betting stocks are friendless when it matters. But that's enough about them.
- Also friendless when the chips are down, may be some other 'disrupters'
- Remember politicians may grandstand & punters have votes, companies don't.

Lateral Thinking - Implication for Crowd-Funding etc.:

- The FT suggests P2P lending & crowdfunding (here) may be curbed
- It says there is 'evidence of consumer detriment'.

Small (but consistent) consumer losses will still prompt investigation:

- Lotteries (small bet, extremely long odds) are heavily-regulated.
- There is evidence that punters will pay the same for 1/10k or 1/1m odds.
- Crowdfunding features crazy valuations, lack of liquidity, unclear exit routes, risks etc.
- Customers & punters (a.k.a. 'investors') may therefore 'need saving from themselves'
- And politicians like to tinker so take a step back, fault the logic
- Legislation may be on its way. It may even happen before the first high-profile failures...

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25 Nov 2016

EVOLUTION: ALTERNATIVE USE OF SPACE:

Change is the only constant. If it didn't exist today, would you build it? If not, then how should you best use the space?

Summary:

High Streets are evolving & even retail & leisure parks are not what they were. Some space may be redundant. How best could it be used?

Complacency is not an option:

Structural change in Retail – long clicks, short bricks…

- Boohoo and Asos' share prices speak for themselves but traditional retail has had a much tougher ride of late.

- The department store sector is shrinking and the only winner is John Lewis.
- When a newer, fresher rival is taking share in a contracting market, that spells big problems for the incumbents (Debenhams, Marks & Spencers, Next, House of Fraser).

Evolution and obsolescence:

- Franco Manca has opened a unit in Debenhams' site at Westfield Shepherd's Bush.
- This joins French Connection and Sports Direct concessions as Debenhams seeks to better utilise space.
- M&S is closing 75 of its stores and is pivoting towards food.
- House of Fraser has warned of a 'volatile trading environment' that is unlikely to change; distressed debt vultures have been snapping up its high yield bonds in Luxembourg.
- This all begs the question: in today's digital world, would you build a department store from scratch?

- The answer is no.
- Similarly, for Game Digital (aka. Game Physical Shops) –would you build an estate of 580 high street stores to sell digitally downloadable games?
- The answer, again, is no.

Excess pub space

- Meanwhile over in the pub sector, Punch Taverns is looking to unlock value in its estate.
- This has so far involved tie ups with Boparan's Harry Ramsden fish and chip shop brand.
- It is on record, along with Enterprise Inns, as saying it has underutilised space.
- Think car parks, beer gardens, upper floors that could contribute more. Young's has tackled this with its Burger Shack, for instance.

- Langton has written of a capacity problem before; even with new sites slowing there is still plenty of slack in existing units.
- As markets and consumers change, physical estates must be proactively managed.

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22 Nov 2016

OVERCAPACITY, CLOSURES & TRADING OUTLOOK:

Operators have announced closures, disposals etc. Some have gone (and some will go) out of existence

Summary:

It's not possible to go from nought to sixty without picking up some clunkers. Repeat. It's not possible to go from nought to sixty without picking up some clunkers. Never was, never will be.

Cheap money, over-capacity, unintended consequences etc.

The factors driving capacity: cheap cash and new ways of raising it…

- Low interest rates have allowed casual dining concepts to flourish. Crowdfunding has also provided an avenue of funding for operators.
- This has resulted in growth for growth's sake and the saturation of the restaurant market.
- Several operators have built substantial estates in as little as three years because of this supply push.

You can't go from 0 to 50 units in a short time without picking up a few clunkers…

- Ed's led the way and we know how that ended (with a distressed sale and 26 of its 59 sites getting shuttered); BrewDog has gone to 50 sites in five years (29 in the UK), Bill's to c60 in three.
- There is also the US invasion to consider; Five Guys has gone from 0 to 58 UK units in just three years. Smash Burger, Shake Shack, and MOD Pizza are also rolling out.

Capacity growth is stalling

- Business investment confidence has taken a hit recently and consumer confidence is fragile.

- Hurdle rates are set to grow due to a cocktail of factors, including: NLW and NMW, the apprentice levy, business rates, currency movements, and supply chain inflation.

- Horizons' 'Ones To Watch' survey earlier this month found 'a decline in the number of new eating out brands… along with a slower rate of expansion for more established ones'.

- CGA data shows strong restaurant supply growth from 2013 to 2015. This has tapered off markedly since summer 2015.

Established operators have been trimming their estates:

- Restaurant Group identified 33 sites for sale or closure in its recent H1 update, while the asset value of another 29 has been written down.

- Wetherspoons has put up an unprecedented 99 pubs for sale since June 2015, many of which are London sites.

- M&B has recently put a package of 75 pubs on the market and Fuller's has also placed some on the market.

- These moves might be driven, at least in part, in anticipation of a tricky 2017.

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The Weather in 2016

- ***A glance at the 2016 weather will help when assessing the comps for 2017***
- ***A wet start gave way to a mild year and an unseasonably warm Autumn***
- ***Temperatures were generally within two degrees Celsius of long term averages***

January carried on with December 2015's record-breaking wet weather, ending as the 4th wettest January since record began in 1910. Avg. temperature was 7.2°C, 0.9°C above avg.

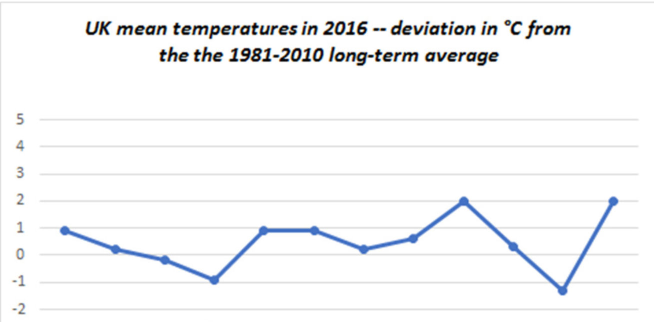

Figure 4 Source: Met Office

February was cold and stormy in the first half before becoming drier and sunnier. Mean temp 0.2° above 30-yr avg. March was also 0.2°C above average.

April's mean temp. 0.9°C below 30-yr avg but the weather was mostly cold, bright and showery and ended in sleet and snow.

May was a warm and sunny month 0.9°C above 30-yr avg, as was warm and stormy June. July was in-line, although the summer ended strongly, with August 0.6°C above average and the warmest day of the year falling on 13 September (34.4°C).

The final quarter of the year comprised of an in-line October, cold November (1.3°C below avg.) and notably warm December (2.0% above avg.).

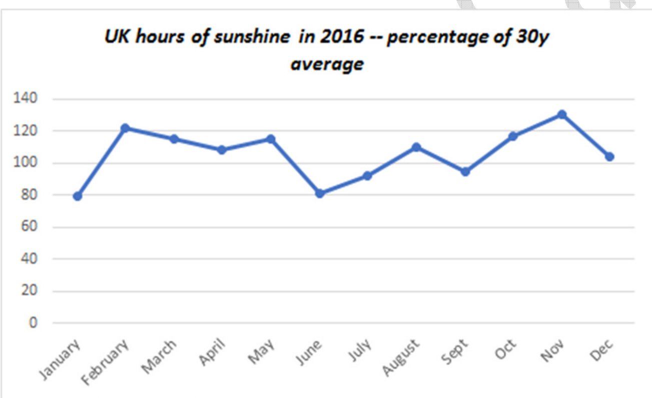

Figure 5 Source: Met Office

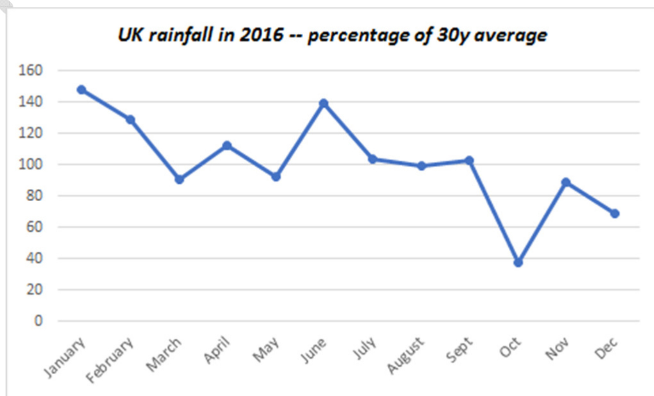

Figure 3 Source: Met Office