

RESTAURANTS AND BARS REPORT 2020

SERVING UP SUSTAINABILITY

UNDERSTANDING THE CONSUMER BEHAVIOUR -
KEY TRENDS SHAPING THE SECTOR IN 2020



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THE RESTAURANTS AND BARS REPORT 2020

This year, the topic of sustainability plays a big part in our report as we pay close attention on the upcoming change in legislations, and how our operators are tackling this major hot topic.

We're delighted to include an interview with Jo Wilkinson, Finance Director at North Bar, who talks to us about expansion opportunities in the market and the company's approach to sustainability. We also feature an article from Olivia Jamison and Alex Ibrahim at CMS (UK), who provide commentary on the ten developments in legislation and policy expected to gain traction around sustainability this year.

From our resident BDO experts, we share an insight into the M&A market; how you can retain the value of your business after sale; and an insight into the types of challenges you may experience when dealing with the National Minimum Wage in the sector. We also feature our yearly predictions which we expect to see this year in the sector.

A WORD FROM MARK EDWARDS

PARTNER AND HEAD OF
RESTAURANTS AND BARS

Welcome to the 2020 edition of our annual Restaurants and Bars report; your guide to understanding changing consumer behaviour and trends in the sector.

2019 was a complex year for many industries and the restaurant and bars sector is no different. Most operators and investors will be glad to see the back of a year where consumer demand has been patchy and where we have seen a surge in CVAs and administrations.

While recent years have seen better performance from pubs, particularly wet-led as disposable income increases has benefitted their key demographics, the end of the year suggested that the decline in alcohol sales, changes in consumer attitudes, rising health consciousness and increasing competition from supermarkets is beginning to take its toll. Plenty of Boards have tried to ban weather and Brexit as causes of volatility in both top and bottom line, but there is no doubt that fingers are crossed for a better year on both fronts.

Without doubt, we see a focus on the sustainability of businesses as they look forward. This does not just mean sound financial footing or environmental credentials but a broader sense of being fit for purpose for the key markets each operator wishes to serve. More than ever, those operators who are clear in their proposition, deliver it with operational excellence and can offer an experience as part of serving a meal or drink will outperform all else. While 2020 may see some further casualties we anticipate seeing some exciting transactions as the light at the end of the tunnel begins to shine a little brighter.

I hope you enjoy reading the report. If you would like to discuss any of the themes highlighted, or to express your ideas on topics you wish to see in future editions, please do get in touch.

Mark Edwards
Partner



ECONOMIC OVERVIEW

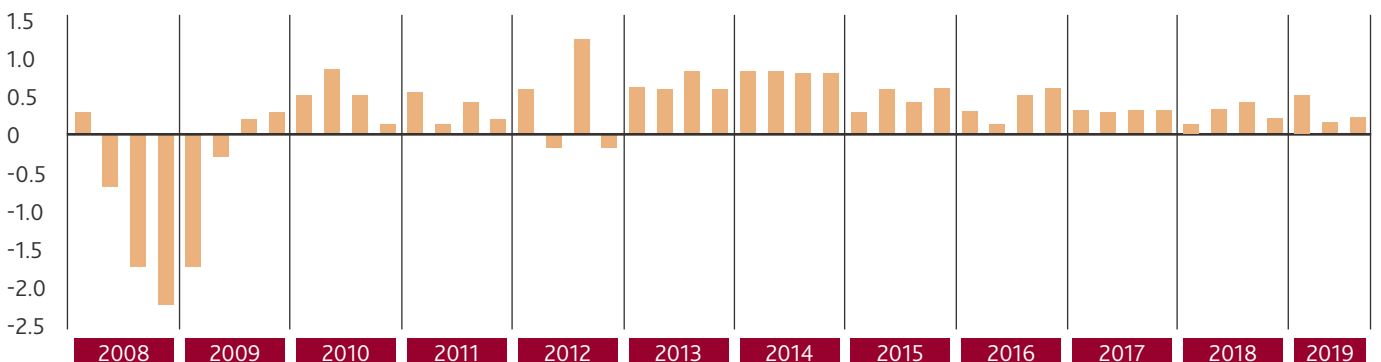
UK'S SLOWING ECONOMY CONTINUES TO DEFY RECESSION FORECASTS

The UK's economy continued to defy predictions of an impending recession, and despite the slowdown in the world's major economies and the continued political uncertainty, Britain's GDP grew by 0.3% in the third quarter of 2019.

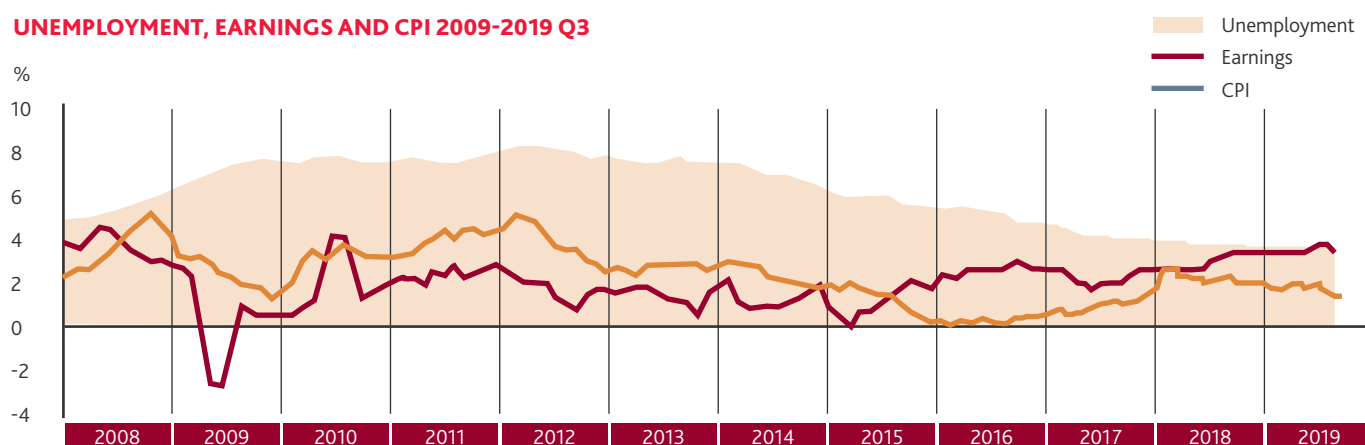
According to the ONS, GDP's quarterly expansion was due to the positive performance of manufacturing in July, the strong pull of services, household spending and a better than expected behaviour in the construction sector. However, in the month of November, GDP fell by 0.3%, which was worse than expected. The ONS mentioned the November decline was driven by falls in both services and production.

Unemployment remains at its lowest in the last 45 years. The unemployment rate in the UK fell to 3.8% at the end of July, compared to 3.9% the previous month, reaching its lowest level since 1974. Salaries continued rising at the fastest rate for a decade, reaching an 11-year high in June, up by 3.9% year-on-year. On the other hand, inflation rate fell to another low in December, down to 1.4% from 1.5% a month earlier.

GDP GROWTH QUARTER-ON-QUARTER 2008-2019 Q3



SOURCE: OFFICE OF NATIONAL STATISTICS (ONS)

**UNEMPLOYMENT, EARNINGS AND CPI 2009-2019 Q3**

SOURCE: OFFICE OF NATIONAL STATISTICS (ONS)

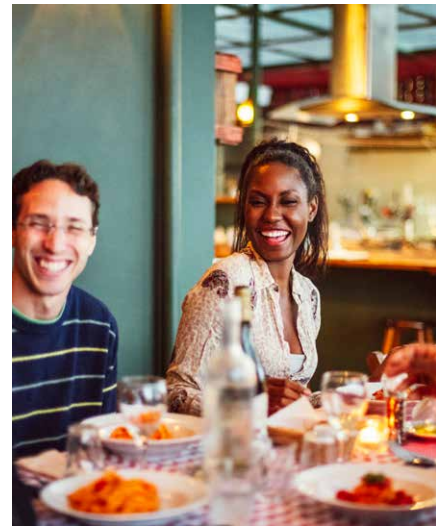
ECONOMIC OVERVIEW

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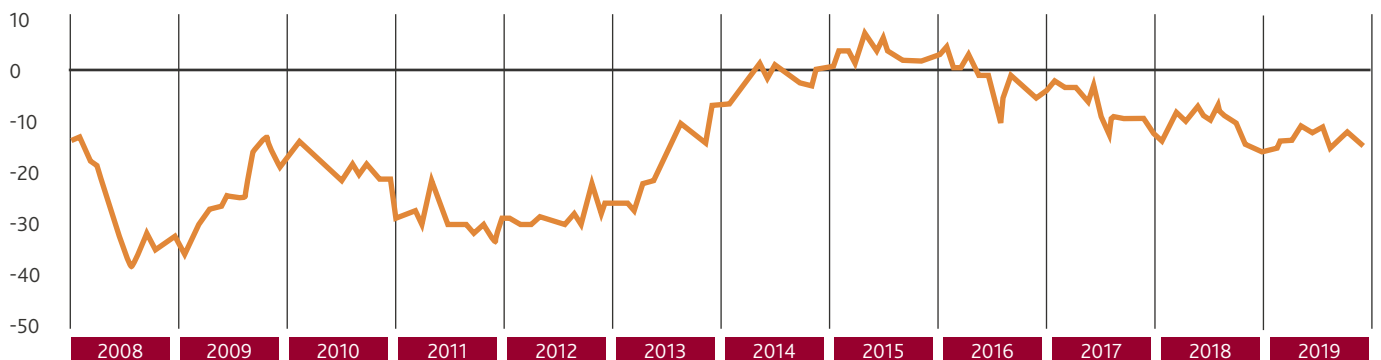
COULD UK CONSUMER CONFIDENCE BE ON THE RISE?

Consumer confidence increased by three points to -11 for December 2019, according to the GfK's index, affected by the continuing uncertainty caused by Brexit. GfK's personal financial situation index, which measures changes in personal finances during the last 12 months, has decreased by three points in December 2019 to -3; this is two points lower than December 2018, while the general economic situation has increased by three points in December 2019 to -31; this is the same as December 2018.

British consumers continue to prioritise experiences over material goods, which positively impacts the restaurants and bars sector. However, despite the small increase in consumer sentiment it still poses a particularly worrying risk for the wider economy, since strong consumer spending continues to be the main driver of economic growth in the UK.



CONSUMER CONFIDENCE 2008 - 2019 YTD CONFIDENCE INDEX



SOURCE: GfK CONSUMER CONFIDENCE INDEX

TRADING CONDITIONS

According to the latest Coffey Peach Business Tracker, collective like-for-like sales across the sector were running at 1.6% for the 12 months to the end of November, which is just below the 1.7% registered at the end of October.

The fears of a recession and prolonged Brexit uncertainty after the initial March 29 deadline continued to undermine consumer confidence, threatening the sector's performance. Despite the risk of consumers balancing their household budgets by cutting down on eating and drinking

out, managed pubs, bars and restaurants experienced a positive performance during the first three quarters of 2019.

The positive collective results demonstrate that people continue to drink and dine out. However, with competition growing fiercely, the risk of stagnation in the eating and drinking-out market remains certain and the faring of the sector during the festive trading season will, once more, be crucial for year end results.

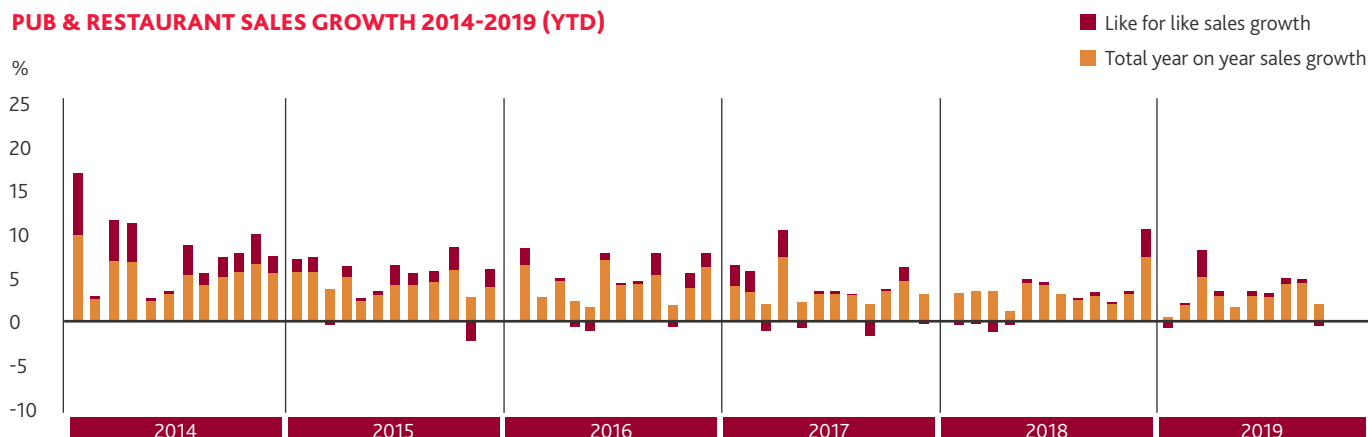
TRADING CONDITIONS: THE NUMBERS

 TOTAL SALES UP **+3.0%**
TOTAL LFL SALES **+0.5%**

 PUB TOTAL SALES **+4.0%**
PUBS LFL SALES **+0.7%**

 RESTAURANTS TOTAL SALES **+0.8%**
RESTAURANTS LFL SALES **-0.1%**

PUB & RESTAURANT SALES GROWTH 2014-2019 (YTD)



SOURCE: COFFEY PEACH BUSINESS TRACKER

DEVELOPMENTS IN THE SECTOR EXPECTING TO GAIN TRACTION

M&A MARKET OVERVIEW



SAMUEL OTTERBURN
MANAGER, M&A
+44(0)20 7034 5889
Samuel.Otterburn@bdo.co.uk

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The Greene King transaction has had a noticeable impact on the market...

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The overt ambiguity with which the government has been purveying messages around Brexit, whispers of a looming recession, faltering consumer sentiment and restaurant CVAs, all combined to make 2019 an M&A year to forget. Despite this, some mega deals have transacted in the sector: Greene King, Ei Group and Fuller's Brewery.

Mounting levels of dry powder due to lower levels of M&A activity has increased the pressure on investors to put this capital to work. Businesses with strong financials and a clear runway for growth will attract investment interest in 2020.

Unfortunately, for several assets, vendor price expectations have not aligned with the market. Strong performing brands, such as Darwin & Wallace and Giggling Squid, are understood to have ended their search for investment due to pricing gaps.

PUBS

2019 saw a number of significant transactions in the pub sector, with several mega deals:

Stonegate (backed by TDR Capital) acquired Ei Group for £3bn, moving Stonegate into the illustrious position as being the UK's largest owner of pubs after assuming Ei's 4,400 strong estate.

Not to be outdone, in October, CK Asset Holdings' acquired Greene King for £4.6bn: an estate comprising two breweries and c.2,700 predominately freehold pubs. The deal represented a 51% premium to the closing share price prior to the announcement.

The Greene King transaction has had a noticeable impact on the market with the

share prices of other listed pub groups surging up to 20% in the week post-transaction. Mitchells & Butlers' share price has now risen by c.50% since the day before the deal was announced.

Fuller's acquisition of Cotswold Inns and Hotels marks its first acquisition since the sale of its Brewery to Asahi in January for £250m. The Cotswolds area has until now been an untapped area for Fuller's, and so the acquisition confirms reports that Fuller's has become less geographically constrained since the disposal of its brewery. Freehold pub groups in the Midlands and East Anglia may soon be receiving a knock on the door.

CEO of Admiral Taverns, Chris Jowsey, has noted that he is looking to increase its estate from 1,000 sites to at least 1,500 over the coming two to three years, having acquired 137 pubs from Marston's in November for £44.9m. Marston's, which is in the process of paying down its existing debt pile, is rumoured to be in discussions with New York-based Fortress Investment Group with regard to the sale of a further 150 of its pubs.

The attractive multiples achieved for Fuller's Brewery, Ei & Greene King will no doubt make competitor CEOs, Boards and Shareholders start questioning what their value could be outside of public markets. There is still great expectation of further transactions and consolidation across the market in the coming years for groups such as Mitchells and Butlers and Marston's.

Young's appears to be the only group bucking the trend with Chief Executive, Patrick Dardis, stating there were no plans for Young's to go down the same route, instead focusing on refurbishing its



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All three businesses offering differentiated concepts...

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Redcomb pubs which were acquired at the beginning of the year.

In addition to Fuller's, acquisitive trade players such as Punch, The Restaurant Group, Young's, Mitchells and Butlers and Stonegate (once it has digested Ei) continue to actively scour the market for high quality pub groups.

BARS

Caprice Holdings (Richard Caring's nightclub and restaurant business), Vinoteca and Ballie Ballerson all received investments during the year. All three business offering differentiated concepts: be it High Society drinking and dining, European-style wine bars, or giant ball pits.

Following in the footsteps of the take-private pub deals this year, Revolution Bars, currently trading below 4x CY EBITDA (or c.2.5x HY Adjusted Site EBITDA), may appear attractive to a private bidder. Despite being at its least profitable level since before the group listed, analysts forecast profitability to bounce back significantly in the years to 2022 – an attractive proposition for any investor that can pull off the turnaround.

COMPETITIVE SOCIALISING AND EXPERIENTIAL LEISURE

The competitive socialising sub-sector has continued to capture headlines over the last year.

Concepts such as Social Entertainment Ventures (Bounce and Flight Club USA

DEVELOPMENTS IN THE SECTOR EXPECTING TO GAIN TRACTION

M&A MARKET OVERVIEW *continued*

operator) saw investment from Acropolis in August and secured a further \$20m growth fund with the family investment office in November.

In June, Puttshack also revealed accelerated roll-out plans following the completion of a £30m equity raise with lead investor Promethean Investments, alongside a significant reshuffle of its top-level management team

BDO advised the shareholders of All Star Lanes on its sale to Luke Johnson's Risk Capital, marking the PE House's return to the market after Patisserie Valerie and subsequent sale out of administration to Dublin based Causeway Capital.

It is widely anticipated that the competitive socialising / experiential leisure sector will continue to attract investor interest over the coming years. Watch this space...

FOOD HALLS

Food halls have continued to surge in popularity throughout 2019.

Operators such as Market Halls, Mercato Metropolitano and Incipio Group (Pergola & The Prince) continue to capture market share from the casual dining sector (and one another) by offering consumers a myriad of fresh dining and drinking brands - all under one atmospheric roof.

These open plan concepts have cemented their place in the eating and drinking out market. With their temporary residents

offering everything from Peruvian fried chicken to Taiwanese steamed buns, a dynamic proposition that is difficult for casual dining brands to compete against.

The popularity of the food hall has not been lost on investors. Edition Capital backed Incipio Group in March. Bridgepoint invested in Market Halls in June, where co-founder, Andy Lewis-Pratt, has stated he is looking to consolidate the market. Imbiba are the latest entrant, having backed Dan Warne and Graham Turner in the opening of Sessions Market in Brighton.

COFFEE AND BAKERIES

The coffee and bakery sub-sectors continue to show a shift towards premiumisation.

Propel reported that Crosstown Doughnuts, London's leading artisan doughnut and speciality coffee brand, are looking to grow the omni-channel business across the UK and internationally.

Sky reported that the Risk Capital-backed bakery chain, Gail's, has appointed advisers to prepare the business for sale. The 50 plus-strong business is expected to receive a raft of interest from both Trade and Private Equity buyers.

Boston Tea Party became the first UK cafe group to ban single-use coffee cups and are on course to remove all single-use plastic by June 2020. The West Country-born café chain is also set to announce its best ever year.

DELIVERY

Key themes continue from last year as growth in the home delivery market puts pressure on bricks and mortar operators.

Just Eat continues to grow its top line at well over 30% per annum while it assesses offers from Takeaway.com and Prosus. Deliveroo's meteoric rise has been well reported over the last couple of years - the online food delivery company looks to maintain this growth path with a paradoxical move into the click and collect market through its new Pickup service.

With a fascinating 2019 now behind us, here at BDO, we are all looking forward to seeing how the 2020 Leisure market unfolds and which exciting brands we will see transacting.



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...an attractive proposition for any investor that can pull off the turnaround.

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AN INTERVIEW WITH NORTH BAR



NEIL EBDON
DIRECTOR, AUDIT
+44(0)113 290 6119
Neil.Ebdon@bdo.co.uk



JO WILKINSON
FINANCE DIRECTOR, NORTH BAR

“

Investing in our teams through training and development results in them feeling genuine affinity for the vision and values of North.

”

With numerous challenges facing the sector and many businesses fighting to stay afloat in today's difficult trading environment, we at BDO are really interested in speaking to distinct and growing brands who have developed a concept that works for the modern day consumer.

Opened in 1997, North Bar is one of those businesses. With six venues in Leeds and Harrogate, North Bar has taken a different approach to selling beer and has now become one of the original pioneers of the bar boom in Leeds and the North. Neil Ebdon, Audit Director at BDO, talks to Jo Wilkinson, Finance Director at North Bar, about expansion, opportunities in the market and the company's approach to sustainability.

Jo, tell us about North Bar's story so far to now, what does your brand stand for and what do you want to be known for in the market?

So the business began back in 1997 when the owners (John Gynge and Christian Townsley) realised there wasn't anywhere in Leeds they wanted to drink. They set up what may be considered as 'the first craft beer bar in Britain'. Now the group has six North Bar venues and its own brewery. We've also recently launched the City Tap in Leeds which showcases our brewery products and there are already plans in place to roll out this concept in other cities.

Our vision for North is to be known for being friendly, safe, inclusive, independent spaces; welcoming open-minded individuals, serving the best drinks, playing great music and above all offering the very best in customer and table service, whilst building a culture that makes us one of the best employers in the UK.

Over the years, we've seen North Bar expand across Leeds and the wider Northern region; talk to us about the wider market; how are you continuing to grow/expand against this challenging economic backdrop?

It's a long time since John and Christian were behind the bar – the bar and beer industry have changed massively (for the better!) in the past ten years. We need to listen to our teams to know what our people and our customers want. We recently had an away day where we worked collaboratively on key values for North and defined our mission. We have gone through a significant period of growth and with that comes

change. This is a key focus for the directors and we want the buy-in of our staff. It was a great opportunity to gather feedback, and as a result, we realised that the values are aligned throughout the organisation. It was also really important for the team to hear and learn about the legacy that John and Christian are creating.

Investing in our teams through training and development results in them feeling a genuine affinity for the vision and values of North. This creates a link between staff and customers and customers and bars. The assumption is that, in times of economic uncertainty as we have been experiencing, people are spending less but we see this as people are spending more wisely. We are constantly looking for improvement to stay ahead of the strong competition. We aim to be the best in all aspects; our consistent table service offering is an example of that, as well as welcoming staff and inclusive product range. This kept us recession proof following the financial crash and hopefully we continue to weather the current economic storm!

With this in mind, how do you envisage North Bar's growth moving forward?

There is huge potential for our business and a lot of opportunities for us at the moment. However, everything we do we look at critically and it has to be right for the values we have as a business. We are really excited about the opportunity to roll out the City Tap concept into other cities, which also includes a partnership with Little Bao Boy who are an Asian street food vendor.

We are currently looking at a new site for our head office and brewery, bringing everyone together in one space and allowing



us to work together in a more collaborative way. We will also develop the new tap room as a training hub for internal and external hospitality professionals. A key reason for the relocation is the need to expand the brewery with unprecedented demand for our product both in the UK and overseas.

We've seen sustainability become a hot topic across the world and in the UK; tell us what sustainability means to North Bar and how are they approaching the topic?

There are three key areas of focus for us when it comes to sustainability.

Firstly, keep doing what we are doing. This is an obvious thing to say but we have seen so many examples recently of big businesses failing. We are a relatively small business but we take corporate governance seriously. We focus on leadership and management so that our teams can drive us to success.

Secondly, we focus on employing a growing number of people. We want to become an industry leading employer and we are investing in our team to achieve this. We are constantly looking at remuneration reviews, training programmes and 360 feedback. We ensure our teams understand their individual customers and how their needs and wants are changing over time. We also think it is really important to reward people properly for the high expectations we have of them. We offer a good benefits package: cycle to work scheme, flexible working hours, TOIL and paid overtime, individual as well as professional development, opportunities for travel (to festivals), support in charitable work (including some paid leave) and favourable employer pension contributions.

Finally, we focus on contributing to the local and regional economy. An example of this is our Eat North concept, which we run alongside Leeds Indie Food, where we have street food businesses with similar values to ourselves come to our brewery site every Saturday. The focus here is on the experience of the consumer and we are helping to build and strengthen the independent business community in Leeds through this event. We will continue with this at our new premises and also use the opportunity to act as a hub and co-working space for our team, friends and industry partners.

The social impact is key for many businesses; tell us more about the charities you have worked with and how this has made a difference.

We pick a different charity to work with annually. We've raised more than £33k for St Gemma's hospice and £17k so far for Action Against Hunger. We've done events such as a rowing race across Windemere, skydives, Jordan trek and a three Peaks walk. We lead by example with the directors involved. Christian raised £3k riding coast to coast in a day and he and John ran the Bilbao half marathon.

And what about the reduction of plastics and waste?

As part of our Eat North events, we don't book a street vendor that doesn't use Vegware – everything is biodegradable. Our associations with Little Bao Boy and Little Dumplin Boy are underpinned because they use fully biodegradable consumables. We have also launched a partnership with local independent venue Pizza Fella which is run

through Leeds Bike Messenger. This is a local, greener alternative to Uber Eats and Deliveroo.

Within our City Tap bar concept we have no general waste. All our drinks are in cans or glass and we use cardboard for packaging. We also only use biodegradable straws.

More strategically, as part of our head office and brewery expansion plans, we have applied for a clean air grant. We already have a cycle scheme and we are planning to install electric vehicle charging points. The idea of the expansion will also be to reduce the amount of intra-site journeys and we will be encouraging the use of work bikes by our staff.

We have an environmental champion whose responsibility is to look at the whole business, across all sites, with the aim of reducing our carbon footprint and the volume of waste that we generate. We recently attended a taster session on reducing energy usage. As we fit out the new site we are thinking of options around solar technology, battery power and heat reclamation.

There is always more that can be done and we continue to look at improvements. Even the smallest things can make a big difference. Areas we are currently looking at are sourcing organic cotton for merchandise in 2020 and printing our menus, posters and point of sale more sustainably.

Every decision we make as a management team includes considerations about our impact on the environment. We believe that this is important for the long term sustainability of our business.



A tricky question, but how do you see Brexit impacting the business? Are there any specific concerns or opportunities?

Nobody knows! There is so much uncertainty at the moment.

A lot of our products are purchased from distributors overseas so unfavourable exchange rates is a concern – these would be passed on to us but favourable ones probably wouldn't!

We have seen people are spending less but they will spend on a high-quality experience. So we need to be the best. Focusing on a robust business model is all we can do.

Looking to the future of the sector overall, what do you foresee as some of the biggest consumer trends shaping pubs and bars in 2020?

It's difficult to say but there are definitely some which spring to mind.

No or low alcohol drinks – We have a collaboration with independent soda producers Square Root from Hackney coming up. They visited us in Leeds in late November to brew a low abv sour. This will be both released as a lower abv option throughout the festive period, and blended with their artisan sodas in bottles to create a low abv radler style shandy. This has been stocked in all our bars throughout January, giving an innovative low alcohol option for those doing a 'dry-ish January'. We also have 'Lowlander Wit' which is a permanent line in all our bars. This resulted from a pop-up at our Preston bar last summer. Some of our team are sober despite working in the drinks industry and felt like they had finally found a proper drink that wasn't a sorry substitute!

Fruit infused beers - We sell many and even make our own. Colour appeals and is very photogenic.

“

There are three key areas of focus when it comes to sustainability...

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When we posted our first TFG our Instagram, engagement doubled overnight. Since releasing in April 2018 we have gone from 8k to 33.7k followers.

Ready to drink cocktails on tap - At Leeds City Tap we have permanent Aperol Spritz and Negroni on tap. These appeal to our demographic in the bar, and ensure our speed of service is maintained throughout busy periods. At North Bar Leeds we have a permanent tap from Mikropolis in Copenhagen. These are brewed by Danish brewery, BRUS, who are leaders in their field. We are heading to Copenhagen in February and have been in conversation with BRUS about brewing a beer together. We will also explore the possibility of a cocktail collaboration with them.

Instagram lifestyle – People want drinks and spaces they can photo and show off. People are becoming savvier about the design of the spaces in which they socialise. They want to be able to post photos from venues.

Branding - Influences come from music, travel, food, science and exploration.

Push the boundaries of how a can should look on a shelf, of what a simple drinks menu can look like or how illustration can be used playfully.

Pop ups – Food offerings take up time and resources and people can do it better than us. Street food is trendy and Leeds has a thriving independent scene. We are looking to expand pop ups beyond just food. For example, a travelling print fair, links to the arts community, and DJ's.

Innovation - We treat each bar as an individual venue, and tailor our innovative efforts around that.

For example, we opened our Leeds City Tap as a cashless venue in November 2018. This is a busy, corporate area of the city and we felt it was important to have a fast service. However, we believe that being cashless would alienate some of our customers in our neighbourhood bars in the Leeds suburbs.

This does not stop us from innovating in alternative ways in these venues. These bars are a fantastic opportunity to introduce customers to products outside of their comfort zone. Through auto-dropping each special release from North Brewing Co, we are enabling them to sample a wide variety of styles, from a brewery that they have a level of familiarity and trust in.

THE MENU FOR 2020

TEN DEVELOPMENTS EXPECTED TO GAIN TRACTION



OLIVIA JAMISON
PARTNER, CMS (UK)

“
...‘business as usual’
is not on the menu
for lawmakers and
other stakeholders...
”

After a year filled with Blue Planet, reports explaining the consequences of global warming, Parliamentary declarations of a climate emergency and the actions of Extinction Rebellion, readers will be aware that ‘business as usual’ is not on the menu for lawmakers and other stakeholders including consumers.

Reducing resource consumption, particularly relating to packaging, single-use plastic and food waste is of increased legislative scrutiny and action. Restaurants and bars are impacted on many levels from supply chain issues, waste management, restrictions on takeaway packaging and resilience risks. Olivia Jamison, Partner, and Alex Ibrahim, Of Counsel at CMS (UK) set out ten developments either expected or expected to gain traction for the sector in 2020 and beyond.

1 UNITED NATIONS' SUSTAINABLE DEVELOPMENT GOALS (SDG) ('THE GLOBAL GOALS')

The 17 Global Goals adopted by UN Member States in 2015, aim to achieve a

better and more sustainable future for all by 2030. Covering a range of challenges, each of the goals have a list of targets measured with indicators. SDG 12 Responsible Consumption and Production aims to halve per capita global food waste at the retail and consumer levels and reduce food losses along the production and supply chains by 2030. The UK government reaffirmed its commitment to the SDGs in its revised waste strategy in December 2018 and, during a national review of progress towards the SDGs in June 2019, acknowledged that increased efforts need to be taken to address climate and environmental issues. At present, food business operators are being encouraged to start annually reporting their food waste transparently, on a voluntary basis, prior to mandatory reporting obligations being introduced. Nearly 100 food business operators have committed to the Food Waste Reduction Roadmap launched by WRAP and IDG in 2018, agreeing to publish details of their food waste. Scotland has an existing target to reduce per capita food waste in Scotland by 33% (from 2013 levels) by 2025.

2 IMPLEMENTATION OF THE PARIS AGREEMENT

The 2015 Paris Agreement committed 188 nations to keep rising global temperatures below 2 degrees Celsius above pre-industrial levels and to attempt to limit the temperature increase even further to 1.5 degrees Celsius. The UK government has committed to the target of achieving net zero greenhouse gas emissions by 2050 (compared to its previous target of at least an 80% reduction from 1990 levels). This target was made law in June 2019. To achieve the net zero target, the



ALEX IBRAHIM
OF COUNSEL, CMS (UK)

government will need to implement a wide range of policy measures across every sector, underpinned by legislation to drive change at the required pace. One step is a new package of energy efficiency measures announced in October 2019 which includes plans to improve the energy performance of rented commercial buildings, including bars and restaurants, by raising the minimum energy efficiency standard of Energy Performance Certificate (EPC) band E to B by 2030, such that premises with an EPC rating of below B could no longer be rented out without undergoing energy efficiency improvements (subject to certain exemptions).

3 CIRCULAR ECONOMY ACTION PLAN

In December 2015, the European Commission adopted a Circular Economy Action Plan to develop a carbon neutral, resource-efficient and competitive economy and boost jobs, growth and investment. The European Council has called upon the European Commission to continue to work in this area and to create a new Circular Economy Action Plan with targeted actions. In particular, focus is on circularity systemically across the value chain, including food from the consumer perspective. It emphasised the need for more measures to tackle plastics and suggested that eco-design principles could be broadened and applied to new product groups, including by introducing criteria on material efficiency (ie durability, reparability, recyclability and recycled content). The procurement of products and services has been identified as a way of boosting circular markets and investments in sustainable cycles. Also identified is the use of economic



instruments such as environmental taxation, green tax reforms, extended producer responsibility to promote the circular economy, sustainable production and improved waste management. These aims are being implemented throughout a number of proposed policy measures and consultation. What you see below is only the start.

4 EU PLASTICS STRATEGY

The Plastics Strategy seeks to transform the way plastics and plastic products are designed, produced, used and recycled. Its key objective is to ensure that all plastic packaging on the EU market is reusable or easily recyclable by 2030. It proposes a set of measures aimed at improving product design, increasing recycled content reducing single-use plastics, tackling marine litter and microplastics pollution. It also mentions introducing compostable and biodegradable standards and the separate collection of plastic waste, as well as encouraging investment and innovation in the value chain. Be prepared to see more devices for refillables in bars and restaurants and separate waste collection facilities.

5 SINGLE-USE PLASTICS 'SUP' DIRECTIVE

The SuP Directive imposes a ban on oxo-degradable products and the supply of plastic straws, cutlery, plates, balloon sticks, food containers, expanded polystyrene cups and plastic beverage stirrers within the EU market. The ban is to be implemented by EU Member States across the EU with effect from July 2021. Other measures under the SuP Directive include the requirement for beverage containers up to 3L in volume

to have caps/lids that remain attached, and for PET bottles to incorporate 25% recycled plastic by 2025, and SuP beverage containers 30% by 2030. Query whether this will increase the supply costs of beverages in these containers and for any own brands these changes should be noted.

Legislation specifically banning plastic straws and plastic drink stirrers in England (subject to certain exceptions including the supply of straws by a catering establishment together with food or drink for immediate consumption), is planned to come into force in April 2020.

6 PLASTIC PACKAGING TAX

The UK government is expected to introduce a tax on unfilled, imported or UK manufactured plastic packaging with less than 30% recycled content from April 2022. Initial proposals were consulted on in early 2019. The technical consultation and draft legislation are expected to be published late 2019 or early 2020, which will further consider: the appropriate method of taxation (a flat rate per tonne currently attracting most support from stakeholders); and whether filled plastic packaging imported into the UK should also fall within the tax. The additional tax is likely to be passed on through the supply chain.

7 REFORM OF THE PRODUCER RESPONSIBILITY PACKAGING WASTE REGIME

Under UK-wide proposed plans for the reform of the producer responsibility packaging waste scheme, producers will be responsible for the full net cost of managing their packaging waste from 2023 (currently producers only meet 7-10% of

this cost). It will cover all consumer-facing packaging but not packaging waste used for commercial or industrial applications (such as shrink wrap and pallets). The proposals are intended to incentivise innovation and change in packaging design, and also include the introduction of mandatory labelling requirements and closed loop packaging waste recycling targets for 2025 and 2030. The government is currently undertaking further analysis on the proposals and intends to consult on the detailed design of the Extended Producer Responsibility (EPR) scheme in early 2020. This is expected to significantly increase costs to producers which may be passed on.

8 BEVERAGE CONTAINER DEPOSIT RETURN SCHEMES ("DRS")

At present both Scotland and the rest of the UK are considering DRS. Scotland is further ahead and there may be a separate scheme for Scotland, subject to consultation, by April 2021. In Scotland a 20p deposit will have to be applied to PET, aluminium and glass drinks containers between 50ml – 3L, and producers will have to comply with registration, record keeping and mandatory collection obligations and targets. Retailers will be obliged to operate return points. Businesses that sell drinks to be opened and consumed on-site, such as pubs and restaurants, will have the choice as to whether to charge the deposit to their customer (rather than it apply it mandatorily) and will only be required to return containers sold on their premises. Note that every obligated article will be subject to the deposit fee as between producers, wholesalers and retailers so pubs and restaurants will have to pay the deposit fee which will be reimbursed to them.



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Legislation specifically banning plastic straws and plastic drink stirrers in England is planned to come into force in April 2020.

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The UK government consulted in February 2019 on the implementation of a DRS in England and Wales by 2023. Further consultation on the detail of the scheme is expected in early 2020. It is likely to cover the same types of drinks containers as the Scottish DRS, which many anticipate will act as a blueprint for the rest of the UK.

The Scottish government launched a consultation on 7 November 2019 on proposed legislation for a Circular Economy Bill. The Bill is expected to include measures to impose charges on single-use plastics and introduce a 'latte levy' on single-use beverage cups, restrict the supply of certain plastics and require mandatory public reporting of waste and unwanted surplus stocks by Scottish businesses.

9 EU ACTION PLAN ON SUSTAINABLE FINANCE

In March 2018, the European Commission adopted an Action Plan on Sustainable Finance to integrate Environmental, Social and Governance (ESG) considerations into its financial policy framework and mobilise finance towards sustainable investment.

A number of legislative changes have been introduced which are expected to impact businesses from 2020 onwards, including the introduction of an EU-wide unified classification system for environmentally sustainable economic activities; a framework and standards to promote 'greening' the financial system; and guidance to improve corporate disclosure of climate-related information.

10 UK GREEN FINANCE STRATEGY

The UK Green Finance Strategy, published in July 2019, includes a number of recommendations for government actions and investment. By 2022, the UK government expects all listed companies and large asset owners to disclose in line with the Task Force on Climate-related Financial Disclosures' recommendations. This requires the disclosure of climate-risk exposure across key areas such as governance, strategy, risk management, metrics and targets.

In summary, there are developments at international, EU and UK level, which will impact upon the restaurants and bars industry, at every stage of the supply chain. In addition to legislative and policy change, businesses must also adapt to the shift in consumer behaviour. Further, those wishing to attract investment will be under scrutiny to demonstrate compliance with ESG across all levels of their business. Understanding the connection between the various developments, anticipating future changes and undertaking strategic planning to allow for adaptation will be crucial to avoiding any adverse impacts. It will also allow businesses to identify and leverage opportunities arising from such developments, of which there could be many.





HOW CAN YOU RETAIN VALUE DURING THE SALE OF YOUR BUSINESS



CONOR LAMBERT
DIRECTOR, CORPORATE FINANCE
 +44(0)207 893 2191
 Conor.Lambert@bdo.co.uk

Taking the decision to sell your business is not an easy one; even if you have been thinking about the idea for years, pushing that button to start the process can be stressful and highly emotive.

This is especially true during a time of economic uncertainty and political turmoil, in particular within the restaurants and bars sector that is consistently battling low consumer confidence, intense competition and government policies, with the resulting rise of businesses in distress. However, the market is cyclical and will rebound, and there is plenty of capital looking for a home, so we look towards the remainder of 2020 and beyond with cautious optimism and expect there will be deals to be done.

There are many great businesses in our sector and whilst in the past year it has been challenging to get deals across the line (eg Giggling Squid taking their business off the market), there are positive investment stories (such as Loungers' IPO and Wagamama's sale to The Restaurant Group) and there are positive reports of other business looking at their investment options. The market still has appetite for transactions, with significant private equity dry powder regularly reported, particularly where the deal is right.

Looking at the specifics of doing deals in the restaurants and bars sector, we continue to see investors focusing on hot topics such as National Living Wage (NLW), National Minimum Wage (NMW), service charges and staff availability; you need to have strategies to deal with these issues.

Investors will also want to understand your business in as much detail as possible and will take comfort from the knowledge that you understand your business and its key drivers, so you should look to compile useful financial and operational information for as long a period as possible (eg like-for-like (LFL) sales, site metrics, and other key performance indicators) and be able to comment on the trends these show.

With the above in mind we have sought to provide an overview of some of the key points you should consider and plan for to ensure you sustain the momentum through a sale process and retain value in your business.

PLAN IN ADVANCE

While pushing the button on a transaction may still be some time away, it does not

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Know that when it comes to valuation, the initial offer is just the start and there will be price adjustments for the issues identified in diligence, as well as level of cash....

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mean you should be any less active in your planning process. The sooner you can start getting your ducks in a row the smoother the process will be and the likelihood of retaining value in your business will increase. Up to two years in advance we recommend you start to consider some of the following:

- ▶ **Define your plan:** Understand your reason for selling and know your future plans (are you intending to stay involved or seek a full exit), as investors will want to clearly understand this and what their exit might look like
- ▶ **Seek advisors:** Look to appoint the right advisors as soon as possible (eg M&A, legal and diligence), as they can guide you through the process and avoid unwanted surprises. It is the M&A

advisors role to coordinate and manage the process for you, so you can continue to run your business

- ▶ **Be prepared:** Know that when it comes to valuation, the initial offer is just the start and there will be price adjustments for the issues identified in diligence, as well as the level of cash, debt and a normal level of working capital, which may mean the final amount paid can be significantly more or less than initially offered
- ▶ **Early diligence:** Carrying out early diligence on yourself (known as vendor due diligence) will likely enable you to identify potentially difficult issues in advance and gives you time to address them and present your business in the best light to the market
- ▶ **Do your research:** Know your target market for potential bidders (eg Corporate vs Private Equity) as their approaches to the process can be very different and this will impact some of your planning – an M&A adviser can assist here
- ▶ **Plan:** Start planning for how the event will impact on your personal tax position, as the sooner you do so the more you will understand about the best timing for the transaction and what you will really take out in cash terms, which is critical to your decision making process
- ▶ **Manage resources:** Build the right team for the process and going forward, add resource early if required and incentivise the right people to support you to achieve your goals; this might be an upfront cost but can save you significantly in the long run.



BE AWARE OF THE CHALLENGES

There are many well documented challenges in the restaurants and bars sector at the moment, so ensure you have considered them, the implications for your business and how you plan to address them, such as:

- ▶ **NLW, NMW and the Apprentice Levy:** There was plenty of publicity about the +£10 per hour rates being discussed by both major parties during the election and the current government's approach to each of these over the next few years will play a major part in the industry's cost base (see page 24 for more information)
- ▶ **Challenges of staff availability:** As the impact of a reduction in net immigration will continue to hit the hospitality space more than most, you will have to start planning for efficiencies and ensure you are ready to address the associated questions where you have a growth strategy
- ▶ **Rent and rates:** Another hot topic with investors seeking to understand your property costs, being one of the largest fixed costs in this industry (all against the background of CVAs and administrations)
- ▶ **Impact of the new tech led delivery culture on your offering:** The growth of Deliveroo, Uber Eats and Just Eat has led to questions about sustainability of margins and quality. Know where you fit into this world
- ▶ **TRONC and service charges:** Be very clear about what you do in relation to tips and know that this will come under intense scrutiny during a process.

KEY BIDDER CONSIDERATIONS

Potential investors will have a wide range of concerns and the more you can pre-empt and address them well in advance with clear, concise and consistent data gathering and analysis, the more likely you are to impress the eventual bidders and maximise your consideration. There are some key areas that can be supported by capturing the right data, for at least two years in advance of a transaction which includes:

- ▶ Like-for-like performance and understanding the differences between your sites (eg by geography, size and vintage)
- ▶ Covers and average spend per head
- ▶ Site locations for new openings and the process from selecting a site to opening night
- ▶ Ramp up periods post opening and periods to site maturity
- ▶ Understand ROI and payback period on capital invested, including refurbishment cycles
- ▶ Understand your working capital requirements
- ▶ Generally consistent and robust operational and financial information that reconciles with each other and the statutory accounts
- ▶ Ensure you have a robust internal controls environment
- ▶ Today's investors are going to assess your ratings (eg social media secret diners).

Remember, don't shy away from past issues, address them head on and show you are capable of dealing with challenges.





UNDERSTAND YOUR FUTURE

Once you have captured the historical story of the business and can clearly illustrate the key drivers, you should then ensure that you have a clear and supportable plan for the future. The following questions should be front of mind:

- ▶ Can you articulate the key value drivers of your business to potential bidders?
- ▶ Have you planned for key management succession and progression?
- ▶ Do you understand what your growth prospects are and do you have a detailed business plan to deliver these?

Make sure you set realistic and achievable budgets for the years running up to the transaction and for the period over which the transaction will take place. This builds confidence in what you are selling, that you are not at a high risk of falling short and that valuations can be supported, retaining the confidence of the investor group throughout.

As a final piece of advice, don't let the process derail you. Ensure you remain sufficiently focused on the day-to-day running of the business and allocate transaction responsibilities appropriately. The pressures and time demands of a transaction can be great, but do not underestimate them, particularly if you are trying to open new sites during this period. You don't want to damage your valuation or worse, the core of your business, by getting wrapped up in the process where the day job ends up being neglected. Lean on support such as an M&A adviser and vendor due diligence provider and make sure to take a firm grip of the timing that works for you. There is a lot to consider but this should be an exciting time for you and the business, so make sure you get to enjoy it too!

NATIONAL MINIMUM WAGE – ARE YOU GETTING IT RIGHT?



ROB ENNIS
SENIOR MANAGER | EMPLOYMENT
TAXES, GLOBAL EMPLOYER SERVICES
+44(0)147 332 0850
Rob.Ennis@bdo.co.uk

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So where can it go wrong, and what can employers do to improve their NMW compliance procedures?

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Introduced in 1999, the National Minimum Wage (NMW) has transformed the UK labour market and today provides protection for minimum levels of pay for approximately two million workers.

At first glance, paying the appropriate rate appears to be a straight forward matter. However, particularly in recent years, ensuring that the NMW is paid correctly in all cases has become more of a challenge for employers. This is especially relevant for hospitality, where pay models often include tronc allocations which do not themselves count towards the NMW.

In terms of enforcement, HM Revenue and Customs identified £24.4 million in NMW arrears (across all sectors) in 2018/2019, affecting over 220,000 workers. Where underpayments are established, a 200% penalty will also apply (capped at £20,000 per worker). In addition, although currently under review, public naming of employers deemed to be in default of the rules can lead to reputational damage.

So where can it go wrong, and what can employers do to improve their NMW compliance procedures?

The remainder of this article examines ten common errors made by employers which have resulted in underpayments, penalties and the naming of many UK businesses - including familiar brands. All can apply where workers are earning at, or near, NMW levels.

1 INSUFFICIENT TIME RECORDS

While the majority of employers will pay the correct hourly rate, many are at risk of challenge on the basis that they are unable

to evidence the actual number of hours for which payment should be made. Within the hospitality sector, rotas often record the number of shifts allocated, but not the actual hours worked. In addition, unpaid breaks can lead to a challenge if they are not properly recorded.

2 UNPAID HOURS WORKED

Following on the above, workers can often be asked to carry out additional activities not strictly included within their day to day role. The NMW of course applies to work carried out. Examples might include:

- ▶ Cleaning/tidying after a shift
- ▶ Cashing-up
- ▶ Arriving before the start of a shift to change into a uniform or protective clothing
- ▶ Being detailed following a shift for a security check
- ▶ Working additional time for which Time Off in Lieu is not immediately provided

3 TRIAL SHIFTS

Most employers will want to understand the level of skills possessed by a candidate, and may reasonably require a demonstration. Where this turns into work however, the NMW must be paid.

4 DEDUCTIONS FROM PAY

While statutory deductions, and a small number of deductions for payments to third parties will not impact the NMW, any amount taken from pay which is deemed



to be for the employer's 'own use or benefit' will reduce pay for NMW purposes. Examples can include deductions for uniform, travel, and meals.

5 EMPLOYEE PURCHASES

Care must be taken whenever staff members are able to purchase a product or a service from their employer, particularly where there is a deduction from pay (even where this is arranged for the worker's convenience).

6 DEPOSITS AND OTHER 'FIRST DAY' DEDUCTIONS

Any compulsory deposits for uniforms, and locker keys can reduce pay for NMW purposes, as would any deductions or payments for equipment or training costs etc.

7 LIVING ACCOMMODATION

The provision of living accommodation is the only work related 'benefit' which can count towards the NMW. However, its value is currently capped at £52.85 per week (including all associated costs). Any deduction or payment above this level will reduce pay for NMW purposes.

8 DRESS CODE

Any requirement to purchase a particular type of clothing to meet an employer's dress code will reduce pay for NMW purposes. This can apply both to new starters and also existing workers who are obliged to renew clothing to continue to meet an employer's

dress code. Examples include a requirement to wear a specific style or colour of clothing/shoes and a challenge can be made even when the worker is not required to purchase the clothing from the employer.

9 SALARIED EMPLOYEES

Specific rules apply to the calculation of pay for NMW purposes in respect of salaried employees. This includes ensuring that all working hours are captured when salary levels are calculated, in addition to ensuring that pay intervals are either weekly or monthly (although this point is currently under review following a consultation exercise which took place earlier in 2019).

10 SALARY SACRIFICE ARRANGEMENTS

Many employers provide benefits such as car schemes, cycle to work arrangements, or allowing pension contributions to be made via salary sacrifice. These arrangements are designed to benefit staff members, and employers will naturally want to treat all of their team members equally. However, any reduction in contractual pay as a result of a salary sacrifice will decrease earnings for NMW purposes (as above, this point is currently under review).

This list is not exhaustive, but provides an insight to the type of challenges typically raised by HMRC in this sector. What is clear is that selecting the correct hourly rate is only the first step in ensuring compliance with the NMW rules. Moreover, while the level of underpayments identified continues to rise year on year, HMRC are unlikely to reduce their focus on this key area of the Government's social and economic policy.

TOP TEN PREDICTIONS FOR 2020



DEMAND FOR EXPERIENCE

2020 will see a shift towards experiences as consumers are now looking for more than just a causal dining environment. With the success from Flight Club's dart concept, it is expected that new activities such as 'immersive' shows, escape rooms and axe throwing will grow along with traditional social activities such as cinemas, theatres and crazy golf.



FOOD HALLS: THE 'FUTURE OF CAUSAL DINING'

Food operators will continue to take over empty property space left over by department stores that went into administration in 2019/18, turning them into food halls. The food hall concept has also expanded to seafronts and commercial districts such as Canary Wharf and Bishopsgate.



TECHNOLOGY AS AN ENABLER

Investment in technology to improve customer services and upselling will see a growth in 2020. By automating processes and harnessing data to generate insights, restaurants and bars can improve the customer and employee experience thereby increase efficiency and maximise profits.



HEALTH CONSCIOUS DINERS

The trends for health will continue in 2020 where we will see one in four now following restrictive diets. With the growth in veganism, zero-proof gin and buying local become ever more important, this trend is set to stay.



CHANGING WORKER HABITS

With more people opting for flexible working and looking for different working spaces, 2020 could be the year where pubs, bars and restaurants investigate the remote-worker opportunity.



THE RISE OF GHOST KITCHENS

The 'ghost' or 'dark' kitchen concept (kitchens which sell meals exclusively through delivery) is set to grow in 2020 and become the norm, as many large restaurants jump onto delivery apps to gain more customers, fulfil orders and save money.



A GROWTH OF EXPRESS FORMATS

2020 is expected to see more casual dining groups move towards small, express formats to cater for the busy, grab and go consumers. With Nando's and Wagamama's grab and go formats, Five Guys opening two smaller stores and Tortilla set to opening stores half its size, this trend is expected to be replicated across the sector.



EXPANSION AND COLLABORATION WITH HOSPITALITY

2020 will see a strong collaboration with bars and hotel chains as drink operators create their own hotels to bring the best guest experience. For example, BrewDog will be opening its first mini hotel in Aberdeen above a bar.



SUSTAINABILITY CONTINUES

With consumers having a heightened concern about the environment, 2020 is set to see more bars and restaurants taking a more active role in addressing sustainability issues such as decreasing the CO2 emissions, sourcing recyclable material and sourcing sustainable foods.



BUSINESS RATES AND BREXIT

2020 will see small restaurants and pubs obtain a reduction in their business rate bills. Also, following the results of the UK general elections, the uncertainty around where labour supply will come from will ease.



SECTOR EXPERTISE

RESTAURANTS, BARS AND PUBS

BDO's national restaurants and bars sector comprises of industry specialists across audit, tax and advisory and offers clients expertise that is focused on their business and resolving unique challenges that arise within this sector.

BDO is recognised as the leading adviser to the restaurants and bars sector, blending sector knowledge and experience with practical advice which is aimed at making a real difference to our clients' success.

With a focus on the economic engine (mid-market) and private equity, we frequently advise entrepreneurial businesses as they grow and offer commercial insight that is founded on sector expertise. We know who is doing what in the market, we are able to benchmark our clients' businesses and provide information on current trends and issues over and above our competitors. With our dedicated transactional team, bolstering our audit and tax services, we are able to advise restaurant and bars throughout their full life cycle.

As thought leaders across the sectors, we offer commercial and technical updates, specifically tailored to restaurants and bars including our annual restaurants and bars reports. We also have a well-established network in the industry that spans finance directors, suppliers and advisers, and we are always willing to use this to our clients' advantage.

RETAIL, LEISURE AND HOSPITALITY EXPERTISE

As well as restaurants and bars, BDO has expertise across the retail, hospitality and leisure sectors with industry focussed teams across retail, hotels, travel and tourism, betting and gaming and professional sports. BDO has a breadth and depth of expertise across each of these industry segments, and we provide business and risk assurance, tax planning, corporate finance assistance, performance improvement advice and personal wealth management to our clients and have a thorough understanding of the sector. We hope that you enjoyed our report and for information on our sector credentials or to receive our thought leadership reports in relation to any of these areas, please get in touch.



CONTACTS



MARK EDWARDS
PARTNER, HEAD OF RESTAURANTS
AND BARS
 +44 (0)207 893 3742
 Mark.Edwards@bdo.co.uk



PETER HEMINGTON
PARTNER, HEAD OF MERGERS
AND ACQUISITIONS
 +44 (0)207 893 2344
 Peter.Hemington@bdo.co.uk



CHRIS GROVE
PARTNER, TRANSACTION SERVICES
 +44 (0)207 893 2163
 Chris.Grove@bdo.co.uk



JONATHAN HICKMAN
PARTNER, TAX
 +44 (0)207 893 2496
 Jonathan.Hickman@bdo.co.uk



CONOR LAMBERT
DIRECTOR, TRANSACTION SERVICES
 +44 (0)207 893 2191
 Conor.Lambert@bdo.co.uk



SIMON FOWLES
DIRECTOR, AUDIT
 +44 (0)207 651 1131
 Simon.Fowles@bdo.co.uk



ED GREEN-WILKINSON
DIRECTOR, AUDIT
 +44(0)207 893 374
 Ed.Green-Wilkinson@bdo.co.uk

FOR MORE INFORMATION:

MARK EDWARDS

+44 (0)207 893 3742
Mark.Edwards@bdo.co.uk

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