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The Impact of the Market Downturn on the U.S. Restaurant Sector

Q: How significant of an impact has the economic downturn had on the industry?

A: The economic downturn hit restaurants particularly hard, but the severity varied across the industry. In general, the more expensive the restaurant the more significant the impact from the recession. Fine dining establishments, like steakhouse chains Morton's and Ruth's Chris, were hit the hardest by the downturn as consumers looked to economize and business entertainment expenditures declined. Quick serve restaurants with their value-oriented offerings, initially weathered the storm well, benefiting from people trading down from casual dining, but more recently have felt the impact of the extended period of high unemployment.

As a result of the recession, we have seen a significant number of businesses file for bankruptcy generally due to a combination of high levels of debt and falling profits, including: Buffets Holdings (Old Country Buffet, Home Town Buffet, Ryan's), Vicorp Restaurants (Village Inn, Baker's Square), S&A Restaurant Corp. (Bennigan's, Steak & Ale), Metromedia Steakhouses (Bonanza, Ponderosa), Uno Restaurant Holdings (Uno Chicago Grill), and Mrs. Field's Famous Brands (Mrs. Field's, TCBY). In addition, several companies were forced to restructure their balance sheets.

Q: What are the lessons learned from the recession?

A: While the restaurant business has always been a competitive business, I think "just OK" or "pretty good" just won't cut it in the future. With unit growth opportunities more limited and profit pressure hopefully subsiding with improved sales, management teams need to focus on restaurant-level execution. At the end of the day, it's all about the consumer's experience. Consumers have too many choices today to be satisfied with sub-par or even average execution.

For growing chains with positive momentum in their brand, a continued vigilance on execution is critical. The positive momentum in their brands attracts the best talent at the corporate offices and, more importantly, the people who interact with the consumer in the restaurants.

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people business. You need good people to provide good food and good service to the customer, which is what brings them back.

Q: What are the current trends you're seeing? Does anything surprise you?

A: In some cases, sales are coming back faster than expected. I expected anemic sales through the first half of the year, but the most recent economic data indicates that the consumer has resumed spending. In addition, the M&A market for restaurants is getting hot very quickly. There were more notable restaurant deals in the market during the first quarter than the total number of notable deals completed last year. Strong businesses have seen broad interest and very good bids. While I think weaker deals will struggle, support from a strengthening debt market will help get the better deals completed. There is a tremendous backlog of transactions, which are due to come to market as the economy continues to improve and more businesses share in the upswing.

Q: What role did consumer confidence play in how the industry weathered the storm?

A: When people are concerned about losing their jobs, they tend to cut back on discretionary expenditures, and dining out is usually one of the first things to go. The decline in consumer confidence during this recession was present across all income groups as even higher income consumers, who are normally somewhat insulated from economic downturns, reacted to the dramatic decline in the value of their investment portfolios. Accordingly, in 2008 and 2009, the restaurant industry suffered through its first back-to-back annual decline in real sales ever, underscoring the severity of this recession.

Q: How can the industry be better prepared in the future to adjust to fluctuations in consumer confidence?

A: The industry needs to be mindful of the consumer's perceived value of their offerings. If management deems discounting is the only way to drive sales, this should be an immediate red flag that the consumer doesn't value the product or the brand. While companies must carefully monitor average check and brand image, considerations might include exploring opportunities to attract customers at different occasions and price points, which could help insulate sales during downturns. For example, a restaurant might consider building a bar business with lower priced plates or creating a more compelling and affordable lunch offering.

Q: Is the value-conscious consumer the new norm?

A: During the downturn, a persistent theme was consumers search for value. Immediately, lower prices come to mind when people think about value, but that doesn't explain Panera's and Chipotle's strong performance during the downturn. These fast-casual bellweathers are relatively expensive options, yet people understood the value in the brands.

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The campaign Subway developed around their “\$5 footlong” promotion completely redefined the value landscape in QSR (quick service restaurants). Chains that did not react with their own compelling value propositions suffered. Even casual dining chains reacted to the price point, trying to match value at lunch.

Similarly, McDonald’s expanded coffee line forced Starbucks to rethink their price points as they saw McDonald’s increase its market share with a value-conscious themed advertising campaign.

So, consumers are more focused on value than ever before, but price, while important, is not the consumers’ sole measure of value.

Q: Are you optimistic about the industry’s prospects for the future?

A: I’m very optimistic about the long-term prospects for the industry in general, but there will be winners and losers coming out of this downturn. Consumers’ expectations continue to rise, and as the economic tide went out, some chains showed their weaknesses.

Even with some macroeconomic headwinds, I believe the industry will prosper because Americans enjoy eating out. It’s an inexpensive luxury. Plus, time pressures remain significant for the average family.

Q: What questions remain around the impact the Great Recession will have on the restaurant industry?

A: I think the biggest question is whether there have been fundamental changes in consumer spending habits. Is the frugal consumer here to stay or will we go back to our old spending habits?

Many consumers traded down to QSR and other less expensive alternatives. This behavior was not limited to the restaurant industry but happened across the consumer spectrum. Many chains, especially in casual dining, discounted at unprecedented levels. Five dollars has historically been the magic number at lunch for quick serve, but even casual chains put the \$5 price point on the board during the downturn.

It will be interesting to see the longer term impact on brands that discounted heavily and whether the consumer will ever pay full price again. When you have trained the consumer to expect discounting, they catch on fast, and breaking the discounting cycle, which usually results in a drop in sales, can be painful.



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