Fast Food Restaurants Have Right Menu for Recession

As the U.S. restaurant industry struggles through the economic downturn, quick-service operators such as McDonald's, Burger King and Wendy's may enjoy a comparative advantage that helps them navigate the weakness better than their competitors in the casual-dining and higher-end segments, according to Moody's Investors Service.

"Fast-food restaurants have a lower average check, greater convenience and increased food choices that resonate well with today's financially stressed consumer," says Moody's VP-Senior Analyst William Fahy.

However, one threat to quick-service restaurants (QSRs) is the option of eating at home, or "trading out," which is almost always less expensive than dining out. "As more consumers choose to eat their meals at home, QSRs will be negatively affected, but to a lesser degree than casual dining," said Fahy.

With a lower price point and an increased emphasis on healthier food options, QSRs should be better-positioned to satisfy the consumer's desire to dine out and save money. This will help QSRs better weather the "trading out" effect, the report says.

In addition to these operating advantages, QSRs also benefit from their predominantly franchise-based business model, which should reduce earnings volatility and capital spending.

Yet amid a weak economy that shows little sign of near-term improvement, QSRs are not immune to reduced traffic, forcing them to cut costs and offer promotions or discounts to stay competitive and attract customers in order to stem deterioration in operating leverage.

Further, a recent history of generous share repurchases and dividends across the industry —- often funded with debt and other non-operating cash flows —- has placed greater pressure on restaurant operators to manage debt loads and maintain credit ratings as the economic downturn persists.

Key points of Moody's report:

- Lower average cost of a meal at quick-service restaurants is an advantage as consumers become ever more frugal.
- Conveniences like drive-thru windows and late-night hours remain a competitive advantage over casual dining.
- New menu options at fast-food restaurants increase appeal for consumers that are more health-conscious.
- Franchise-based business model should provide greater stability to earnings.

- Discounting and promotions become key marketing tool to bolster traffic but squeeze margins.
- Many restaurants, including some quick-service operators, face weaker debt-protection metrics and eroding covenant cushions due to weaker operating performance.

A recent analysis by restaurant industry consultant **John Gordon** showed a mixed picture for fast food restaurants, with **McDonald's** (MCD)**, Chipotle** (CMG) and **Steak N Shake** (SNS) faring better than **Yum Brands** (YUM) and than **Darden's** (DRI) **Red Lobster and Olive Garden**. All were faring much better than fine dining , where sales are down some 15% from a year earlier. Gordon also questions the wisdom of **Wendy's/Arby's** (WEN) following a multi-brand strategy which has not worked well, with the exception of Yum Brands (KFC/Taco Bell).

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