PACIFIC MANAGEMENT CONSULTING GROUP

chain restaurant analysis and advisory

Restaurant Themes, 2018

Now that we are solidly in 2018, a number of commonly heard restaurant themes are being heard and confirmed. The romance and hope behind restaurant ownership hasn't faded; restaurants are after all always investible, they are an important social and needs fulfillment outlet of rising people and cultures everywhere. But money does not grow on trees, its takes some considerable work to develop one's career, manage the brand on an national or international framework and keep franchisees, debt and equity investors happy.

Confusion about playing the long game: Sales results from some brands recently have shocked some investors, what with two or three years downturns here and there, a weak December/January there and the like. But no one should be surprised: US and international consumer trends are variable and change at a moment's notice. People want to go out to eat, but there is no biological imperative that they do. The guest visits have to be earned, and it takes time to build the right business to do so.

Some investors have wondered if franchising is the answer to any short term problem. What they are really looking for is a short-term stock catalyst, something that the brand can quickly do to step around consumer brand challenges. That is a romantic hope; some restaurant concepts are more franchisable than others. Talking to a potential investor recently, they hoped that "local franchisee management" could market more efficiently and turn around the recent bout of same store sales problems. Generally not so; we all know the essence of franchising is control of the brand experience, consistency, conformity (that's why the contracts are written the way they are); that then attract hopefully well capitalized franchisees, who have a great brand economics platform to work, and can grow. In the U.S., most forms of "local marketing" have been transformed into "national marketing." That spells corporate control, the franchisors hire (and change) advertising agencies precisely to flex those national muscles. Unfortunately, this has eroded allowable franchise risk taking and innovation that gets noticed; we wonder if the Egg McMuffin could be invented by franchisee Herb Peterson in 2005 as opposed to 1985 due to how the business culture has changed.

The second observation is that the restaurant sale has become less predictable over time. Despite the good economy, we are not getting the share of spending we would hope for. In the past, the very well-known restaurants peaks and valleys followed macro economic trends. Restaurant expansions occurred followed by down periods in 1962-1963, 1974-1975, 1982-1983, 1991-1993, 2001-2002 and 2008-2009. We all know or can guess what happened during those periods. We always assumed restaurant sales expansion would follow employment, low gasoline prices and US gross domestic product gains.

Data published by Miller Pulse, the restaurant tracker shows of all the macro economic factors, only two factors are somewhat correlated to same store sales: Real Disposable Income (66 percent correlated) and overall industry surveyed Foodservice Sales (61 percent correlated). Unemployment, consumer confidence, nonfarm payrolls have lower or no relationship. The world is more complex. For one thing, no restaurant independents and smaller multiunits have sales tracked until they go public. Not one of the food halls that we have seen across the country are in the same store sales comps database. On the positive side, interest restaurants overall is vibrant by both investors and lenders. At the recent ICR Conference, one veteran restaurant track attendee noted there are plenty of young brands, the next Chipotle or Olive Garden is out there.

5980 Mission Center Road, Unit A | San Diego, CA 92123 | (619) 379-5561
jgordon@pacificmanagementconsultinggroup.com
www.pacificmanagementconsultinggroup.com

That leads to the third observation: those brands that wing it, those that invent new restaurant concepts and sales platforms with very little or no due diligence, testing and corrective learnings put into place are doing a disservice to themselves and the industry. In the U.S., people and real estate are in very tight supply. Restaurants are CAPEX intense, with really the decision to build a new restaurant the most final and unreversable of costs. If a restaurant goes into a new market and fails, there is little option but to close it or sell it/repurpose it to another buyer. Most or all of the capital investment, operating losses and pre-opening expense then is lost forever. Could it be that a major public traded restaurant holding company could expand a brand throughout the U.S. with no consumer research? Yes, you bet. Could it be a major QSR company could roll out a digital platform with no testing? Yes. There is just less room for sloppiness. It takes time and money to make money.

The last common theme heard is ***about the lack of people and difficult labor conditions seen almost everywhere.*** Everyone talks about it. Most are talking about reducing turnover. Some operators would like cut labor hours, or at least cut functions that gobble a lot of the labor hours used. My opinion is that is more doable in the QSR segment, especially with the advancement of digital sales platforms, but for fast casuals, casuals and fine dining it is more risky. With a higher average ticket paid, customers expect more human contact. And for any operator trying to expand catering , there has to be human to human contact. Catering does not grow much with just a menu panel by itself. Some things are more controllable than others and can be done. Sharing best practices is one. Cheesecake Factory can be studied to some degree, as they have been the only restaurant company to show up on the Fortune 100 Best Companies to Work For list.

Other restaurant people challenges are self imposed. For example, we often see waves of turnover that occurs throughout a restaurant organization when the CEO changes. We all know why that is, but why does it have to be? If a District Manager changes in market x, why would that drive turnover in a majority of the units in that District, baring extraordinary circumstances? If it does, then that is a signal of a weak company culture actually in place, versus what is hoped. That also takes time and money to build or fix.

John A. Gordon is the founder of Pacific Management Consulting Group, a restaurant analysis and advisory consultancy. He has a 45 year background in restaurant operations, corporate staff roles and via his consulting firm since 2003. His website is http://www.pacificmanagementconsultinggroup and email is jgordon@pacificmanagementconsultinggroup.com, office (858) 874-6626.