Foodservice CEO

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Amid high inflation, is there hope?

Managing better for the downturn

Inflation has been on a tear in recent months – and restaurants are feeling the pinch. A recent report from the Bureau of Labor Statistics said menu price inflation hit a new 40-year high in March. Inflation of food-away-from-home soared 6.9 percent, year-over-year, the largest annual increase since December 1981. Full-service restaurants experienced an 8 percent year-over-year price increase, while quick-service restaurants weren't far behind at 7.2 percent. Grocery prices were 10 percent higher and the Consumer Price Index overall increased 8.5 percent.

Is there an end in sight? The Nobel Prize-winning economist Paul Krugman, for one, expects inflation to "fall significantly in the coming months." Why? He cites, in part, the bullwhip effect – a term for when products that are at the end of long supply chains generate exaggerated changes much farther up the chain. So for instance, consumers overbuy goods out of fear that they won't be available. Wholesalers then rush to buy more in order to meet the increased demand, straining port capacity and shipping in general. But when demand then drops, according to a report from the MIT Sloan Management Review, "the bullwhip amplifies the downside for all those upstream suppliers that had overinvested in the surge…Each player up the chain suffers a worse and longer fall-off in demand, leading to reduced manufacturing and layoffs, which in turn exacerbate the contraction in demand, leading to and then exacerbating an economic downturn."

So boom leads to bust. But before we get too anxious at the possibility of some kind of contraction on the horizon, it may help to look to historical examples and attitudes of past inflationary periods – they don't necessarily carry through to what we're seeing today. Data from the Federal Reserve indicate that consumers expect inflation in the near term but don't expect it to continue well beyond a year. These aren't the views of consumers from the 1980s,

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Maximize the value of your restaurant's real estate

Whether you want to remodel or sell

Restaurant real estate looks a lot different than it did a couple of years ago. As operators have accommodated more streams of off-premise business, dining rooms have decreased in size, pick-up lanes and windows have been created both indoors and out, and even kitchens have changed shape to adapt to shifting consumer habits. The added pressures of inflation and a potential recession are making this a time when every square foot of a restaurant's real estate footprint needs to earn its keep.

So how do you ensure you're making best use of your space? In a recent webcast from Restaurant Finance Monitor entitled "Creating Enterprise Value Through Real Estate," three restaurant industry experts in investment banking, restaurant portfolio optimization and restaurant law spoke about how to navigate through the current environment.

They said that now is an important time to give your real estate strategy a reality check and identify any opportunities you have to operate more efficiently and generate greater value from your property. "You should do a deep dive into variables like rents relative to market, occupancy costs as a percentage of sales and new restaurant growth prospects," said Joe McKeska, senior managing director and leader of the restaurant industry practice at A&G Real Estate Partners.

Once you do that, you may discover that you could use a portion of your dining room space for a more profitable purpose and you should get going with a remodel before costs escalate further. Or perhaps you're better off finding a new location that can be more easily adapted to your needs. You may find that you have leases you should try to renegotiate – or even stores you should close to help consolidate labor and resources.

Perhaps you're in the market to sell – and that carries its own action items at a time of high inflation. Greg Grambling, a managing director at Salomon Partners, where he specializes in food retail and restaurant investment banking, said the current economy may make potential buyers choosier about buying companies that have too many variable costs in their leases that could jump along with inflation. "As a potential seller," he said, "you can generate leverage and value by acting now" – specifically to make more of your costs less reliant on the Consumer Price Index, whether that includes rent, Common Area Maintenance or lease terms.

How M&A has shaken up the restaurant sector

And how the rest of the year could play out

Following a whirlwind of M&A activity in the latter part of 2021, it's only natural that things could ease up a bit in 2022. After all, it would be a bit surprising to see another year in which a company spends nearly $900 million in five months of acquisitions, as FAT Brands alone did last year.

So what's in store for 2022? Morven Groves, vice president of 10 Point Capital, expects the flow of deals to slow. He recently told QSR Magazine that valuation expectations remain high as a result of the transactions that have occurred over the last 18 months. However, deals at such high levels need companies to deliver strong growth – and uncertainty abounds concerning restaurants' ability to deliver on their growth projections amid supply chain strains, competition for real estate, and inflation.

Nick Cole, head of restaurant finance at Mitsubishi UF Financial Group, said restaurant companies have seen their margins shrink as costs have climbed and as labor challenges have impacted business. He predicts those lower margins will slow the pace of M&A in 2022. "The M&A market depends on a well-capitalized banking system flush with liquidity, which we currently have," he said. "But cash flow — and the price acquirers are willing to pay for that liquidity — are the primary drivers that attract buyers, so unless we see an improvement in margins, we expect the pullback to be significant."

But the good news is there is money out there to fund acquisitions – particularly those that can scale quickly and deliver on their brand promises. Once some of the turbulence in the economy settles down, that could spell opportunity for the businesses that have weathered the bumps of the past two years most efficiently.

Inflation
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who saw inflation as far more entrenched, Krugman says.

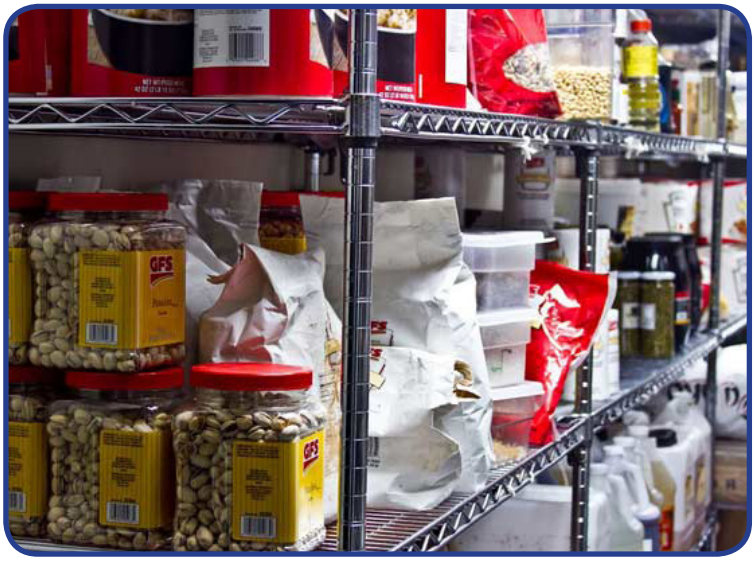
Wherever possible, restaurant operators should prepare now to minimize the stress of a downturn. The MIT Sloan report suggests businesses can better insulate themselves by taking actions including these:

• Conserve cash by reducing inventory levels, increasing days payable outstanding, and reducing days receivable, while being careful not to endanger the viability of key suppliers.

• Reduce your supplier numbers, focusing on large and robust ones.

• Reduce your product varieties focus on the fast sellers.

• Focus on lower-priced and private-label goods as consumers become more frugal.



Using tech to enhance customer control

Consumer customization isn't going away. In fact, looking beyond your menu to give your customers even more options to customize their experience may help you gain a competitive advantage. Tech is enabling those changes. According to Dana Macke, the director of trends for the Americas at Mintel, current efforts to expedite delivery are going to evolve into efforts to offer greater flexibility. That means that going forward, restaurants will be able to give customers greater control over when their delivery order arrives, for example. We can also expect greater use of predictive technologies to help restaurants ensure their guests' orders are tailored to their schedule and needs. Can you enhance the customization of your customers' ordering experience?