Foodservice CEO

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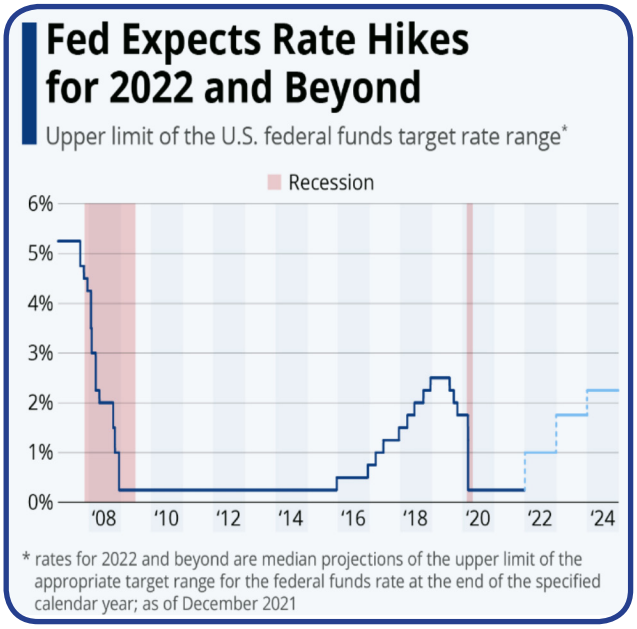
February 2022

What rising interest rates could mean for restaurants

Interest rates are expected to climb this year – and for the first time since 2018. As inflation has reached 40-year highs in recent months, the Fed is sure to use the key tool it has in its toolbox to chip away at it. While we can't say for certain what interest rate increases are coming in 2022, the prevailing opinion of experts in the financial sector is that the Fed will raise rates at least four times (and perhaps up to seven times, according to newly adjusted predictions from Goldman Sachs).



Sources: U.S. Federal Reserve and Statista

While those increases are likely to happen gradually to help slow the economy enough to reduce prices without intensifying unemployment, they may still be unsettling. After all, we have been living in an era of nearly-free money for some years now. What's more, there aren't many cases of central banks curbing inflation without sending the economy into recession.

But it's important to put the increases in perspective. For instance, even amid multiple increases, interest rates are likely to remain low when put in historical perspective. The Fed has said it anticipates getting rates back to around 2 percent by 2024 and there are factors keeping downward pressure on rates in the longer term. As a February report from The Economist said, "In the long run the world's aging population will keep a cap on interest rates. That points to an unpleasant financial squeeze, rather than a return to the 1970s."

Still, the knowledge that interest rates are likely to rise should prompt some strategic thinking for restaurant operators – both about how they look at potential deals and how they approach financing.

Restaurants with a lot of debt could see declining profits as interest rates rise. Alternatively, those with a lot of cash stand to make more money for the same reasons. A company's decision to move forward with a merger or acquisition will depend on their balance of debt and cash.

In a January webcast from Restaurant Finance Monitor, Cristin O'Hara, Bank of America's managing director and group head of restaurant lending, said restaurant operators should be developing some pro forma financial

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Is it time to scale up?

Across the decades, the restaurant sector seems to shift between assembling larger collections of restaurant brands and then slimming down their portfolios. The pendulum has been swinging toward bigger collections of restaurant brands in recent months, with the challenges of the times justifying the need for restaurant holding companies to seize business opportunities and diversify their portfolios. Last year was an especially active one for mergers and acquisitions as the restaurant sector began to rebound following Covid lock-downs. The pent-up demand following 2020's challenges spurred restaurant holding companies to expand their existing platforms and represent a more diverse cross-section of the industry. On the extreme end, that resulted in Fat Brands acquiring restaurant companies such as Global Franchise Group, Twin Peaks, Fazoli's and Native Grill & Wings in a matter of a few months.

Having increased scale can provide important protections in the face of the challenges restaurants are managing today, including supply and labor shortages, as well as the need for new technologies to improve the efficiency of operations. Larger restaurant collectives can parlay their scale into preferential purchasing agreements with suppliers and more favorable contracts with third-party delivery companies and technology providers. They can offer more appealing opportunities and benefits to potential hires and more easily adjust staffing to accommodate new store openings and events. A restaurant also doesn't have to be a major conglomerate to benefit from scale: Even small-scale scaling up can offer similar advantages to brands with a handful of locations.

But is scaling up for everyone? Since times continue to be unstable, with coronavirus variants still posing risks, inflation persisting and interest rate increases looming, it makes sense to proceed with caution. While scaling up offers some key advantages, it also exposes a business to additional risk. Scaling up a business often helps a business reach more customers and increase cashflow, which in turn helps it invest in new capabilities that will help it continue to grow. But it also generates new expenses – and if you have underestimated sources of competition or consumer demand (which has been going through a period of transition in recent years), scaling up may generate more stresses than it eases. Further, while a restaurant can gain supply-chain efficiencies at scale, it can also multiply the headaches of not being able to source critical ingredients needed by a range of restaurant brands. Taking advantage of the supply-chain efficiencies requires a business to have a detailed, real-time view of its inventory, as well as an ability to pivot quickly to predetermined back-up plans when menu ingredients are late, early, overpriced or unavailable.

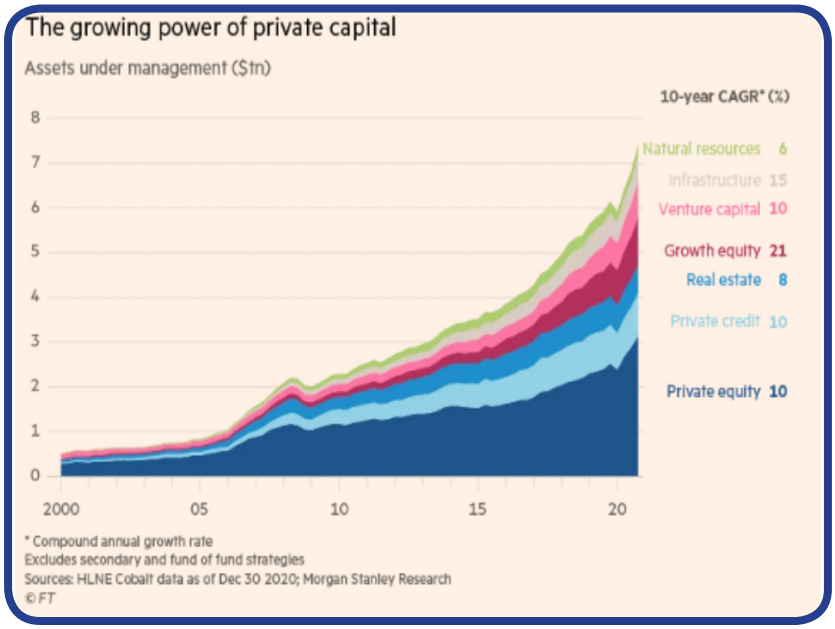
Let's make a deal

Times of uncertainty create opportunity – and the restaurant industry offers plenty of both these days. Investors and lenders are watching. After all, it could be a great time to get a favorable deal on an undervalued investment or to make some money on businesses looking for some help to stay in business or to reach the next level. Are you looking from additional support, whether by pursuing a higher-stakes private equity investment or by simply seeking some additional financing with fewer strings attached?

Private equity investors have great interest in the restaurant industry. In the U.S., the pandemic has magnified how much consumers value their favorite restaurants. Further, since the restaurant sector is among the only sectors that is unaffected by the likes of Amazon, private equity investors see many opportunities. For restaurants looking for additional resources to bring greater efficiencies to their operation, expand into new markets, or tap into investor expertise in finance and management, pursuing these partnerships may help bring a growing business to the next level.

They can also generate problems if the partners disagree on goals, lack shared values, or have different short- and long-term priorities. This can damage the restaurant's relationships with employees, customers and suppliers. To determine whether to pursue a private equity investment in the business, approach expert advisors at the outset who can guide you through the process, provide advice on the ideal investors for the business, and help you understand your company's standing and value in the market in order to determine a fair purchase price. Investment will require compromise, so clarify your goals and values at the start so you understand what lines you are willing and unwilling to cross – and what values you need to share with your investors. Do your own homework so you're prepared to share and discuss balance sheets, cash flow statements and other documents that explain your business results and strategies. At the end of the process, you should have a clearer understanding of your risks, the steps you must take to mitigate them and what factors make your business an attractive investment. An investment banker can then help you clarify your pitch to potential investors.

Perhaps your business simply needs an extra infusion of capital for a technology investment or a remodel to make your operation more profitable. This is another area where financial institutions are eager to make deals. (Even DoorDash has entered the market recently by offering financing to its restaurant partners.) As rising interest rates loom, it's a good time to refinance, if desired, and to develop relationships with lenders who are looking to put good assets on their balance sheets. Having a strong lending partnership will give you more solid footing when you're ready to make strategic transactions down the line.



Source: Financial Times

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New plan to respond to foodborne outbreaks

At a time when the supply chain is stressed, it's all the more important for operators to be able to know and trust the sources of the food they serve – and to be alerted quickly in case of problems. To support that process, the FDA recently announced its Foodborne Outbreak Response Improvement Plan, which includes input from (and an independent review by) the University of Minnesota School of Public Health. Food Safety News reports that the plan focuses on four areas of priority: tech-enabled product traceback, developing better systems around root-cause investigations of outbreaks, strengthening the analysis and dissemination of outbreak data, and making operational improvements to better evaluate the timeliness and effectiveness of foodborne outbreak investigations.

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statements – and probably a number of them depending on their view of how many interest rate increases will occur. They should also think about their financial leverage when making deals. "If a franchisee wants to go on the outer edge of their leverage, I think interest rates rising will have more impact on them versus someone who has a lot of cash on hand and doesn't need to take the last dollar of leverage that they have." Sometimes that leverage is needed – but having a cushion of cash right now will put operators in a stronger position going into the increases.

The year of the back-up plan

Supply challenges could persist for the remainder of 2022 and into next year, according to the prevailing commentary from restaurant industry analysts. Consumers are well aware of the shortages and are experiencing them at grocery stores themselves, along with higher prices as compared to restaurants. But with a little planning, you can entice guests to order from you and avoid reminding them of the inventory (and staff) you may lack week to week. Now is a good time to develop a contingency plan for the year, to cover recipes, ingredients, promotions and equipment. First, scrutinize your recipes and look for ways to flex them with a range of ingredients – swapping in different vegetables, grains, sauces and spices, for example. For each dish, have a roster of back-up ingredient options that you can turn to if a key ingredient isn't available. Be able to make quick adjustments to your physical and online menus based on your supply so guests aren't in the position of ordering an advertised dish only to be told it's unavailable. This is yet another year when operators will have to do more with less, so consider how you can serve guests in a way that is as resource-efficient as possible (and then incentivize guests to support you in that way). If you want to elevate your takeout business to ease the burden on your staff or manage better with a skeleton crew, for example, you could offer a discount when guests submit an order for collection before 5:30pm – or whenever your dining room normally begins to get busy. Finally, look at your cooking equipment and try to forecast what is likely to need a replacement or repair. Then, look to simplify your preparation and menu so you aren't so heavily reliant on individual pieces of equipment that could let you down and take extra time to be repaired or replaced.

A publication from Team Four Foodservice