State of the Restaurant Industry

November 2022
Introduction

Overcoming inflation

Restaurant operators ended 2021 feeling optimistic about how the industry had successfully pivoted and adapted to a new business model. Everyone was looking forward to a post-COVID world with a strong consumer environment. And then 2022 presented a new headline problem — inflation.

While operators tried to compensate for food price and wage inflation, housing, grocery and gas increases cut into customer confidence. Now, with the Fed raising rates, inflation should ease and unfortunately consumer spending along with it. The industry is anxiously awaiting positive signs, but the threat of a Fed-induced recession is on the horizon. As always, though, smart operators and strong brands are positioned to prevail — especially in a world where consumer appreciation for restaurants has grown.

Our 2022 report covers all the critical developments, with key insights from industry leaders.
Where we are now

Inflation is hurting, but restaurants are resilient

- Food price inflation was the big curveball of 2022, and operators hiked menu prices to try to compensate, though most couldn’t sustain their prior margin profiles.
- With high inflation across the board, some consumers are opting to eat at home, while others are trading down.
- Restaurant sales correlate to gas prices and consumer sentiment — providing some relief as gas prices have come down in recent months.

For many in the restaurant industry, after climbing two mountains in 2020 and 2021, 2022 has felt as if they scaled another impossibly high peak, only to reach the top and discover there’s still another mountain to climb.

“A lot of us are surprised by how 2022 has unfolded, and unexpectedly are less upbeat about the restaurant industry compared to last year,” says Restaurant Head for Bank of America, Cristin O’Hara.

Vice Chairman of Investment Banking for BofA Securities, Roger Matthews, describes it this way: “The journey began in March 2020 with COVID. The restaurant industry had to deal with a once-in-a-hundred-years immediate demand issue; people just stopped going to restaurants due to the pandemic. So everyone worked hard, pivoted to takeout and delivery and narrowed menus and operations. COVID didn’t go away as quick as we thought with a few headaches along the way, but by the end of 2021 everyone was hopeful that the worst was over. Then we reached the promised land of 2022 — and all of a sudden inflation exploded. Everyone knew labor would be higher, but it’s continued upward, and finding people is still tough for many. Then there was the increase in gas prices, followed by the big curveball, massive food inflation.”

Although in August average wholesale food prices declined slightly overall, July prices were up 16.3% over the previous year, which represented the 12th consecutive month of double-digit increases. And for many food items critical to restaurants — from chicken to eggs, cheese and butter — the increases have been even more dramatic. Restaurants had no choice but to increase menu prices to try and protect profit margins or at least “penny profits” even if margins were lower.

Average wholesale food prices have risen by double digits for 12 consecutive months*.

But as the price of gas, housing and other consumer goods and services also climbed, overall inflation took a toll on consumer confidence. The result? After a 20% rebound in 2021, to a total of $799 billion, restaurant sales began to flatten or fall in summer 2022. Eating and drinking places posted total sales of $86.2 billion in August. But adjusting for menu-price inflation, sales have fallen for three straight months since peaking in May.²

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Cristin O’Hara
Restaurant Group Head
Bank of America

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The National Restaurant Association reported that a majority of surveyed restaurant operators said same-store sales were down in July compared to the previous year, after 17 months of increases. A majority of operators also reported lower customer traffic beginning in June, when gas prices were hitting record highs.1

An uncanny correlation exists between gas prices and restaurant sales. As gas prices increased through May and peaked in July, that is the exact time that restaurant sales came down on a year-to-year basis. As gas prices started to drop, restaurant sales started back up. August’s card spending data from Bank of America backs that up, showing that consumer spending on restaurants was up 2.2% versus the prior month, after three months of declines.

Heading into the final months of 2022, the industry outlook is unclear, partly because of how the pandemic affected actual customer behavior relative to consumer sentiment. In addition, BofA Global Research economists now forecast a modest recession for 2023.

BofA Global Research economists say, “Consumer sentiment used to be a pretty good indicator of consumer spending, particularly on discretionary items like restaurant meals. What happened at the start of the pandemic was that people were feeling low, but they were buying things. When inflation picked up, consumer confidence hit all-time lows, but people kept spending. That represents a big disconnect between how people were feeling and what they were spending. And that’s created an issue with using and understanding consumer sentiment figures right now.”

In the meantime, there are signs that consumers are pulling back on restaurant occasions. “Based on Bank of America card data, we’re seeing some real declines in consumer spending adjusting for the price increases taken by restaurants over the past nine months,” BofA Global Research economists say. “It’s likely that is disproportionately impacting the less-affluent consumer.”

While some consumers are simply opting to eat at home—or feel they can’t afford to eat out—others will trade down. Senior Relationship Manager for Bank of America, James Short, says, “In every recession, we’ve seen movement from fine dining to casual restaurants, and casual dining down to quick service restaurants (QSR). For instance, in 2008, in the worst year of the recession, while full service was down seven points, QSR was only down four. But right now, lower-income consumers, because of the increases in rents, groceries and gas, are being pinched worse than others, and just may not have the money to go to the drive-thru. Those brands that have catered to the less affluent consumers may be hit disproportionately worse in the coming months.” And with all of this discussion around topline softening, there is no question that margins are lower for those restaurants that own and operate their stores, as menu price increases have not fully offset overall food inflation.

Despite the challenges, the news isn’t all bad. On the positive side, the industry came out of the pandemic leaner and tougher. Menus are streamlined and operations tighter. The labor situation seems to be stabilizing, and both customers and employers have a new appreciation for restaurant workers. Operators have added myriad options for their customers to order, pay for, pick up and receive meals.

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There is still pent-up demand for eating out. In the most recent National Restaurant Association survey, 46% of adults said they are not eating at restaurants as often as they would like.4

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Labor and operating costs
Which changes are here to stay?

- A shift in labor cost structure should be considered permanent, given the retail industry’s move to a $15 standard wage.
- Wholesale food prices rose 16.3% in July, the 12th consecutive month of double-digit increases, with overall prices up 13.2% from 2021.
- Food inflation is unlikely to go away soon, given issues like weather, climate and the Ukraine war.

Together, food and labor costs account for about two-thirds of every dollar of a typical restaurant’s sales. That’s why 2022 has proved so challenging for restaurant operators and their bottom line.

After increasing wages to attract staff following the initial closures and resignations caused by the pandemic, operators have been hit hard by food price inflation. In confronting this one-two punch, each operator has had to decide how much of those cost increases to pass on to customers, given that some food inflation may be short-lived.

Restaurants — independents, franchisees and chain stores — have increased wages not only to attract workers, but also to compete with other employers, particularly large retail outlets that have upped their minimum hourly wages. “The change in the industry’s labor cost structure is permanent,” says Roger Matthews, Vice Chairman of Investment Banking for BofA Securities. “When major employers like Target, Amazon and CVS move to a $15 wage, it doesn’t matter what the federal minimum wage is. Restaurants have to compete.”

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James Short
Senior Relationship Manager
Bank of America
The economy is rotating back from goods to services, and the labor market is rotating to services as well. The question is, how much friction will there be in that rotation back?

Senior Relationship Manager for Bank of America, James Short, explains, "Overall the industry has started to retain employees, and increased benefits are helping to reduce turnover. Even though restaurants have had to increase the average hourly rate, they're reducing overtime costs. It's somewhat equaling itself out. The labor picture is stabilizing; the increase in labor as a percentage of revenue is leveling off."

However, the labor picture still has room for improvement. Although restaurant industry employment has rebounded, as of August, eating and drinking places still were 5% below pre-pandemic employment levels, according to the Bureau of Labor Statistics. In a National Restaurant Association survey, two-thirds of operators said their restaurants still don't have enough employees to support higher customer demand. "We are in a historically tight labor market," BofA Global Research economists say, "with many people leaving the labor force during the pandemic. Now, with federal stimulus payments over and consumer prices high, how many of those workers will start looking for jobs again? And how many people who took jobs in warehouses and delivery will move back to hospitality?" Those are critical questions for restaurants in particular. "The economy is rotating back from goods to services, and the labor market is rotating to services as well," the BofA Global Research team says. "The question is, how much friction will there be in that rotation back?"

But while we're seeing stabilization in the labor market, BofA Global Research economists are not as sanguine about the outlook for food costs. Wholesale food prices posted double-digit percentage increases for 12 straight months through July, according to the Bureau of Labor Statistics. Over the past year, the wholesale food price index has included huge increases for many key commodities. In August, for instance, the price of eggs was up 140% year on year, while butter was up 75.8%, processed poultry 22.9% and milk 23.6%. The fresh vegetables index increased 57.8% from July 2021 to July 2022, with the fresh fruits and melons index up 21.2%. BofA Global Research economists are concerned that food inflation appears stickier. One key contributor is the ongoing war in Ukraine. Not only is current food production an issue, but as the war delays sowing new crops, the future harvest also is disrupted. The war has impacted not only the availability and prices of basic grains, but also the cost and supply of animal feeds and fertilizers — with a downstream effect on items like beef and chicken, and other crops as well.

It's not only the Ukraine conflict that has played a role in the huge increase in food prices. Weather and climate issues have been a big factor, including drought, fires and record-setting heat. Matthews says, "If we don't have water for crops, that makes things like tomatoes more expensive. Brands may find themselves short on French fries next year because the potato crop is coming in weaker than usual."

Some things seem completely out of anyone's control. One mystifying development: Around the world, chickens seem to be laying fewer eggs. Is it avian flu? The environment? Both? No one is sure. When you talk about food costs and food inflation, there are all kinds of moving pieces, and it's difficult to predict what is going to happen. "Chairman Powell isn't the only force influencing the world of food prices," Matthews says.
Payments and treasury

Facing complexity and fraud

- Fraud remains a key concern for operators, both in the front and back of the house
- Customers have myriad new payment options, making reconciling daily cash more challenging
- With more cash on hand, efficient and safe cash management is more critical than ever

When it comes to day-to-day financial management post-pandemic, restaurant operators are focused on two things — managing cash and staying on top of fraud.

In the simplest financial terms, a restaurant operator needs to take customer orders and payments, keep track of and reconcile sales and pay vendors and staff. Each of those functions has become significantly more complex, at a time when operators have a lot of cash on hand and want to optimize that liquidity but also protect the treasury from fraud.

Senior Relationship Manager for Bank of America, Ted Lynch, says, “Consider that 25 years ago, probably 90% of restaurant sales were in cash, with the rest paid with a credit card or a gift card. McDonald’s wasn’t even accepting credit cards until 2004. Today, one of the biggest concerns restaurant operators have is that there are more than a dozen different ways a sale can be recorded.”

It’s the price of driving a truly frictionless customer experience. It’s critically important for the restaurant operator and the bank to partner closely together to integrate payments and platforms alternatives to ensure a seamless experience. According to Head of Global Banking Merchant Sales for Bank of America, Galen Robbins, “Providing multiple payment options is important. But truly integrating them to be part of the restaurant’s overall payment and service ecosystem is ultimately what drives efficiency and return.”

But as the pandemic spurred significant — and sudden — changes in customer payment options, those changes accelerated faster than companies’ ability to account for them. Lynch says, “The decision to accept different types of payments came without us having the systems in place to make reconciliation easy.”

Many ways to pay

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Head of Global Banking Merchant Sales  
Bank of America

If you’re the restaurant manager, it’s hard to reconcile the day’s cash. No human can reconcile the day’s activity easily and fast. But there’s a need for robustness of reporting all your transactions to headquarters. These things are taking up a disproportionate time for people. Lynch continues, “The phrase I hear is that we need general-ledger ninjas to get the quality of reporting we had when we were an all-cash business.”

One system that can help is Bank of America’s CashPro®, a complete digital platform designed to make managing payments and receipts faster and easier, at a time when managing liquidity is paramount.

For many Bank of America clients, cash on hand is higher than in years past. “In a rising rate environment, they have a larger treasury chest to protect,” says Senior Treasury Sales Officer for Bank of America, Charles Murphy. “Fraud has become so prevalent that often it’s all we talk about with clients. You have this larger-than-usual amount of cash, and that presents an opportunity to lose it through fraud. What tools do we have to protect the treasury, and also help them get the highest returns?”

In addition to the need to protect the payment pathways, there’s also the back-of-the-house side of day-to-day financials — payroll and accounts payable. During the pandemic, more office staff moved to remote work, and a lot of that is here to stay. But is it secure? “If you’re an operator, ask: What have you done to ensure the security of working from home?” Murphy says. “If a payroll manager is logged into your system from home, can someone access the company’s payroll files and get a fraudulent payment issued? Or access supplier information, and make a change in address that sends the payment to the criminal?”

He points out that Bank of America’s Complete AP really took off during the pandemic, as a way to make AP faster and safer by sending and receiving digital payments, validating supplier information and optimizing the timeliness of payments.

Murphy believes the mobile feature of CashPro also helps both treasury employees and managers respond in the safest and most efficient way. You don’t have to be tied to the laptop because you can see everything through a mobile device. The tool can help you make the most informed and timely decisions for making payments and increase the efficiency of things like releasing wires so you don’t have to scramble.

Solutions like Complete AP, Comprehensive Payables and CashPro also help companies facing continued labor issues that make an office vulnerable. Although most attention has been focused on the industry’s front-of-house worker shortages, restaurant companies also are struggling to hire employees for the back office as well. “When you’re short on experienced help, when the team isn’t seasoned enough to quickly validate things like supplier information, the Bank’s solutions can do that for you,” Murphy says. “We’re in a better position than clients. We have the tools and the connections with other financial institutions to validate information.”

These tools go a long way in helping operators navigate a challenging time for the industry. And as innovation brings more complexity, those who embrace alternative ways of doing things will ultimately be better positioned for the future.

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Bank of America
Franchisees’ view

Feeling the squeeze

- Franchise operators believe that, although most restaurants are not fully staffed, the labor situation has stabilized.
- M&A activity has ground to a halt as buyers and sellers can’t calculate, or agree on, financials.
- After aggressive menu price hikes, a cycle of discounting and promotion is on the horizon.

Franchisees have been hit hard in 2022 by food price inflation, equipment and supplies delays, increased labor costs, a continuing shortage of workers and difficult decisions about balancing menu prices and profit margins with customer traffic counts — all while paying an increasing dollar royalty to the franchisor.

“The beginning of the year was so difficult, and we were hopeful that we were seeing glimmers of positivity. But most of our franchise operators have not had a good second or third quarter,” says Restaurant Group Head for Bank of America, Cristin O’Hara. “People are shocked that their leverage is going up. Pricing is going up. Margins are getting slammed. Overall, it’s rough going for restaurants right now.”

Operators who own franchises of several different brands are stressed. Each of their entities is getting smacked, in one way or another.

“Many operators have been groping in the dark about how much price increase they can and should take. The issue is both relative and absolute pricing.”

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BofA Securities

Senior Relationship Manager for Bank of America, James Short, agrees. “After rebounding last year, a quarter into 2022 people were shocked by where we were.” A big problem, of course, is the cost of goods sold. In large part, restaurant operators don’t have a lot of control over those costs. They are at the mercy of the commodities markets and food suppliers.

One especially stressful part of the equation is how much of the food price inflation to pass on to customers. “Many operators have been groping in the dark about how much price increase they can...”
and should take," says Vice Chairman of Investment Banking for BoFA Securities, Roger Matthews. "The issue is both relative and absolute pricing. Relatively, you care about what your competitors are doing. If you’re taking a 10% menu price increase and they’re taking 5%, you’re out on a limb. Then there’s the issue of absolute pricing. At some point, price increases can become so aggressive that the customer says, ‘I’m not paying that for this anymore. It’s not worth it.’"

Menu prices are up significantly overall. In August, the price of food away from home was up 8% compared to August 2021, according to data from the Bureau of Labor Statistics. This represented the largest 12-month price increase since 1981. Concerns are, of course, that after raising prices aggressively this year, the industry is facing another cycle of discounting and promotions, which no one likes.

Menu price rises are at historic highs

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Labor costs have also risen, and most restaurants remain understaffed, but Short says most operators feel they have figured out how to manage their workforce. Although supply chain issues remain, with some unpredictable item shortages, the industry is not as affected as many businesses.

For most multiunit operators, investment — both internal development and mergers and acquisitions — has stalled. M&A activity has slowed dramatically, partly because it’s so difficult for buyer and seller to align on future margins.

M&A has slowed, with buyers finding it hard to calculate future costs, sales and margins

"Activity in M&A is not great. It’s impossible when you don’t know what your EBITDA will be in the next few years," O’Hara says. And that’s across brands. Short says there’s a large gap between the seller’s asking price and the buyer’s bid. With the current economic volatility, it’s hard to calculate costs, sales and margins for a full 12 months. "This is the first time in my career where buyers are negotiating the purchase price more on varying EBITDA than the price multiple," he says. For buyers right now, figuring out future EBITDA is more important.

In terms of franchisees’ internal development, Short says, "It depends on the brand and the size of the operator, but in general, operators have pulled back substantially on remodels and new development. That depends on how well the brand was able to weather the environment — if they could take price increases, how their particular cost of goods has been affected, how materially their cash flow was impacted. In addition, larger operators have greater access to capital. Larger systems with larger cash flow tend to have credit that is more flexible, and they may still be developing and remodeling."

Many operators have become more conservative in the face of the current economy and needing to focus on the state of their current house. But operators who are using debt to grow may not have access to capital.

The overall outlook for the franchisee community for the rest of the year is a mixed bag, largely depending on the brand. For example, which brands have new and innovative products coming out, and which have a better mix of commodities? Most operators feel good about the fact that they’ve figured out how to manage labor. That’s a definite improvement over the past 12 months. Short says, "For the most part, restaurants are staffed up, dining rooms are open, and operators are extending hours back out. The cost of goods sold, that’s where everyone is uncomfortable."
The future

What’s next for 2023?

- U.S. consumer demand has held up this year, though the economy is likely headed toward a mild recession in early 2023
- Food prices remain high, but the price of groceries is outpacing that of food away from home, making restaurants a better deal for consumers
- There is a widespread new appreciation for restaurants, an encouraging sign for the future

Although the outlook remains murky for the restaurant industry into 2023, there are a few positive signs: Chicken and beef prices have been heading down, although the impact of a lengthy war in Ukraine still hovers over future food supplies and prices. Additionally, during the summer, the price of food at home (grocery stores) increased at a higher rate than the price of food away from home (restaurants), and that widening price gap makes restaurant meals a better deal for many consumers.

The declining price of gas at the pump should also bode well for consumer confidence and people’s comfort level with spending money to eat out, given the correlation in 2022 between gas prices and restaurant sales. However, as we move into a likely recession in 2023, this could again negatively affect restaurants.

Meanwhile, labor challenges for restaurant operators should ease. With the end of federal stimulus payments and a high cost of living, more people who may have been on the sidelines will need to return to work. “There are going to be more people coming back to the workforce, and that natural return to work will be the story of next year,” says Senior Relationship Manager for Bank of America, Ted Lynch.

When it comes to efficiencies, operators have addressed the cost structure of their businesses, closed underperforming units, streamlined operations, simplified menus, and built out digital capabilities that cater to today’s customers. Demographic trends also favor restaurants. Gen Zers, in particular, “really like restaurants and the experiences they offer, are willing to and sometimes prefer to eat food at home, and are willing to pay for it,” Vice Chairman of Investment Banking for BofA Securities, Roger Matthews, says.

The pandemic-induced shakeout will inevitably mean openings for good operators. “Restaurants that didn’t have the capacity to get through COVID are gone,” Lynch says. “The landscape is fresh for reforestation.” Overall, there’s a sense that, post-pandemic, consumers have come away with a greater appreciation for restaurants and for the experience of eating out.
“The broad outlook is that the labor market is still strong and consumer demand has held up. Headline inflation appears to have peaked. Food inflation remains a problem, but the drop in gas prices from their summer highs has been a pretty significant tailwind.” BofA Global Research economists expect a recession to begin in early 2023 but say it will be “probably quite mild, not particularly bad by historical standards.”

Although Bank of America’s experts remain wary of predictions, everyone is in agreement that the market is overdue to return to normal conditions, and there will be great opportunities when it does begin to turn.

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Cristin O’Hara
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Still, Short says, “People are gearing up to take advantage of what’s happening. Folks that have capital are getting excited about finding some good deals. A lot of people with cash know that there are opportunities out there to pick up a good set of stores at a low price.”

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Gas Prices
Restaurant Sales

When gas prices fell in August 2022, restaurant spending recovered 2.2%.

Source: Bank of America August card spending data.

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