COMPASS™ Restaurant Consulting & Research

The Food Delivery Business – From an Operator's Point of View:

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SUMMARY

- Delivery is here to stay – it fits consumers quest for convenience.
- Consumers' and Technology's influences – consumers' demands; technology's conveyance.
- Operators' responses – a way to build sales.
- What happens in the last mile – first-hand experiences.
- Financial model for Delivery business.

Delivery business is here to stay. The majority of restaurants will adapt in some form or fashion. The 3rd Party model is evolving and will improve its operations. The Restaurant Delivery Model will change and become more profitable.

Several restaurant chains that will excel and lead the industry in the Delivery arena: Panera Bread, Domino's, Chipotle, and Jimmy Johns. Others that will get it right over time: McDonald's and Starbucks.

OVERVIEW

The Food Delivery business began in earnest a few years ago and lately it is generating a significant amount of fixation; almost to the point of obsession. The advancement of the Delivery/Off-Premise business model is no different than when Drive-Thru came on the national scene in the 1970's with the launch of Wendy's Old Fashioned Hamburgers.* Burger King and McDonald's panicked – how could they compete? Wendy's had a designated cookline for their Drive Thru and the others could not accommodate; but they did, and today Drive Thru business represents approximately 60% of total sales in the industry. In fact, many experts in the industry call Delivery the Drive-Thru of the Future. **Drive-Thru has offered and will continue to offer the consumer the primary source for Off-Premise dining convenience.

What Drive Thru has been to the restaurant industry for decades and will continue to have a major role in sales, Delivery/Off-Premise is for now and the future. The reason for the growth of Off-Premise business is consumers are changing rapidly and demanding more. Their demand for more alternatives to the way they dine are changing both in "convenience" and "experience." This shift is real. Lately, the major portion of these demands are for Off-Premise dining options. This growing consumer demand is dramatically changing the restaurant industry. (Off-Premise options are important to driving sales for the present as well as the future.) In fact, the very definition of "convenience" in the restaurant industry has changed. It once meant "close-by, location, easy access"; but today it has evolved to so much more: to what is close by, how quickly can I get it (anytime, anyhow, anywhere), how seamless is the process. This is the new gold standard for convenience. Many consumers want instant gratification; they want it now. With the evolution of purchasing most anything from smart devices and having it delivered at home (the rise of Amazon, etc.), all just fuels the consumers' craving and satisfaction for instant gratification.

Dining rooms have been getting smaller through the years as a result of fewer customers utilizing inside dining. In the late 1960s and 1970s, QSR dining rooms averaged 60-70 seats. During the 1980s and early 1990s, they increased to 100-120 seats. In the 2010s new and remodeled units are now averaging 30-50 seats. The ratios are approximately the same for Fast Casual and Casual Dining. Essentially the large dining rooms of the past are not needed anymore because of the Off-Premise dining preference by consumers.

*Jack in the Box and In and Out Burgers had Drive-Thru service sometime in the late 1940's/early 1950's but did not have a national presence.

**To set the record straight, Delivery is just one component of Off-Premise dining business. The other components are catering, takeout, Drive Thru, branded food trucks, Delivery and a few others.

OVERVIEW SALES TRENDS

The food Delivery business today:

- 58% of all restaurant occasions are Off-Premise.
- 39% are Drive-Thru.
- 34% are Delivery (44% are 18-34 years old).
- 29% are Take-Out.
- Highest usage: Day part:

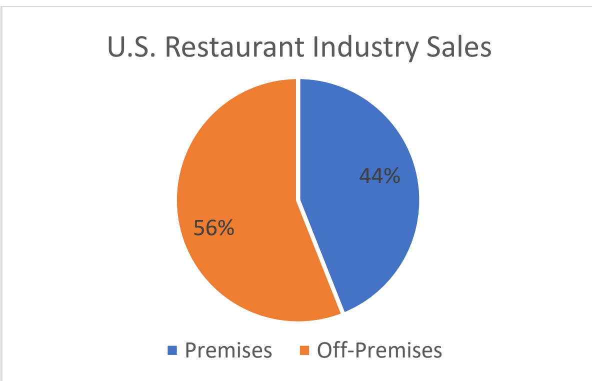
Day part	
Dinner	81%
Lunch	72%
Breakfast	60%
Late Night	56%

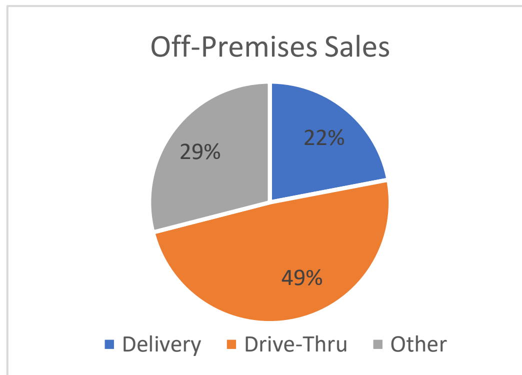
Delivery Sales Growth CP to 2 Years Ago:

Family Dining	63%
Casual	72%
Fine	55%
QSR	49%
Fast Casual	64%

THE MARKET DEMAND HAS SHIFTED QUICKLY

(2018 Represented a Pivotal Year for Delivery / Delivery Services)





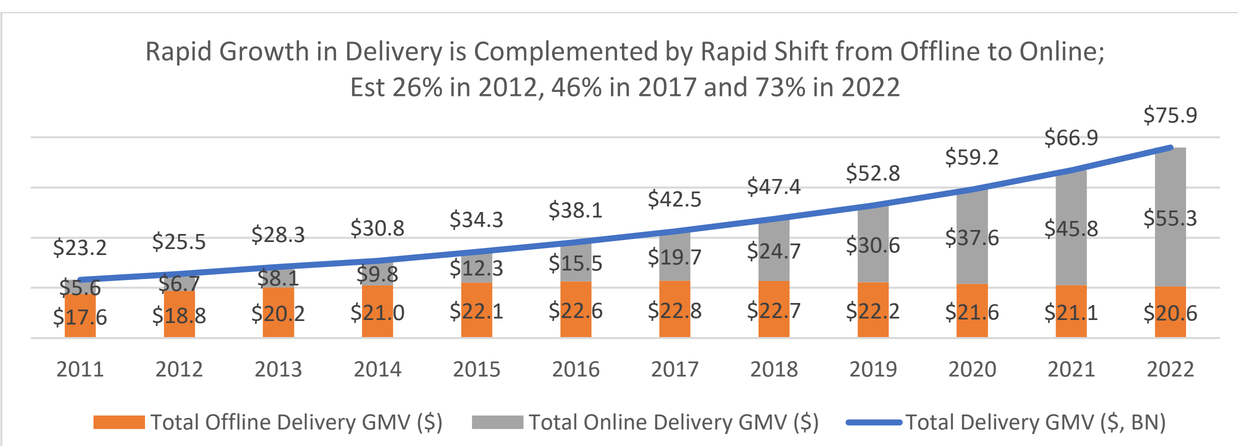
SOURCE: Technomic

65% of restaurants have yet to offer Delivery

SALES

- NRA predicts a 22% surge in Delivery services and other convenience alternatives between 2018 and 2022.
- Restaurant Delivery sales are expected to grow at more than three times the rate of on-premise sales through 2023.
- This growth stems from the changing consumer dining preferences.
- While Delivery/Off-Premise sales have grown over the last 5 years, Dine-In sales have been flat.

Recent study by Cowen & Company on Delivery sales history with future projections:



SOURCE: Cowen and Company, NPD

CONSUMER INFLUENCE

What is driving the consumers insistence for convenience is the ever increasing demands for their time. Lifestyles are changing and becoming busier due to hyper-connectivity. Creating a new type of stress related to information overload, longer commutes, and people congestion in every facet of daily life. Pressed for time, consumers are becoming more impatient and stressed. Because of this, consumers are increasingly looking for solutions that simplify their busy lives – consequently the newer definition of convenience evolved.

Consumers view convenience as a time saver and consider saving their time more valuable than money. They would rather pay the higher prices associated with Delivery to save their time (time to cook at home, time to go out to a restaurant and/or time to pick it up/takeout). Years ago, Burger King had a simple mission statement: "People have two things in life to spend – time and money. When given the opportunity, they would rather spend their money than their time . . ." This adage is just as true today as it was in the 1960's/1970's. Customers want more control of their time. This is at the heart of their demand for convenience and all it entails. However, there is a limit to how much they are willing to pay for Delivery's convenience.

CONSUMERS ARE CHANGING:

The lines are blurring between traditional definitions of demographics model: Boomers, Millennials, GenX – now there is "Modern". The Demographic – a hybrid of many generations that seek common objectives.

The definition of organic, healthy eating, locally sourced, and wellness are all changing as are values, culture, wants, and lifestyles. The pace of change is accelerating. Even the interpretation of eating out is changing.

Consumers' preferences between convenience and a memorable dining experience are merging; they want both. (Operators need to adjust their business model accordingly to stay relevant.)

Delivery is captivating a whole new demographic and is increasingly reshaping the world of consumer e-commerce.

CONSUMERS – WHY THEY CHOOSE DELIVERY:

	18-34 Yr. Old	35+ Yrs. Old
• It's easier	54%	61%
• Prefer not to leave home	45%	57%
• Bad weather	29%	31%
• No time to cook/saves time	28%	31%
• More convenient than Take-Out	23%	19%

CONSUMER ARE DEMANDING – CONVENIENCE, EXPERIENCE, TECHNOLOGY ON THEIR TERMS.

RECENT NPD/CREST 2019 Off-Premise Report:

The report shows there are still a lot of potential for guests to be engaged with Off-Premise opportunities.

	% of Customer Traffic that is Off-Premise (Blend of Chains & Independents)	% of Delivery
Family Dining	20%	35%
Casual Dining	17%	39%
QSR	72%	33%
Fast Casual	50%	52%
Coffee/Snack	73%	22%

The report found that currently 38% of Boomers and 50% of GenX are more likely to have restaurant food delivered than they were two years ago and 28% of Millennials. Consumers' quest for convenience has grown substantially and continues to expand.

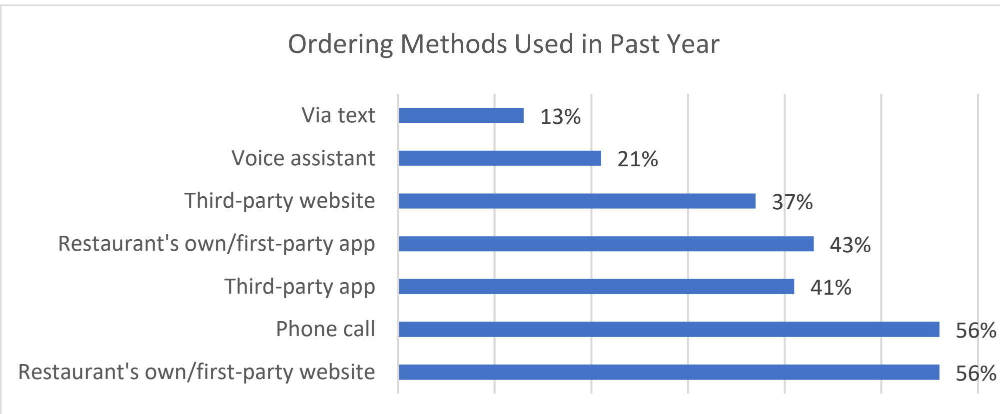
TECHNOLOGY'S INFLUENCE:

Another component of the consumers evolving tastes is their appetite for technology. Technology enables a better dining encounter for both convenience and experience. POS provider, Toast, conducted a consumer survey recently on what are the most important factors influencing a consumer's choice for a particular restaurant.

- 79% said technology improves their experience. Within that heading:
    - 77% - listed Online Reservations most.
    - 56% - Online Ordering.
    - 56% - Free Wi Fi.
    - 50% - Loyalty Rewards Programs.
    - 44% - Mobile Payments.

These numbers provide a compelling insight about today's consumer. They live in a digital/on demand world and they want it all: the choice to get their food the way they want, when they want it, how they want it, the option to interact digitally, and the insistence on a great dining experience.

CONSUMERS EMBRACE TECHNOLOGY FOR FOOD ORDERS:



SOURCE: 2019 National Restaurant Association and Technomics, Inc.

<u>TECHNOLOGY = CONVENIENCE; Consumers Have Stated</u>:

35% That it is easier to customize their order on a restaurant's own site or app
35% That ordering on a 3rd Party site/app is faster than the alternatives
33% That many of the restaurants they order from do not have their own sites

- Technology is changing everyone's life. Boston Consulting Group Study (October 2018) reported:
    - 60% of consumers have downloaded a restaurant app.
    - 40% of those ordered restaurant delivery.
    - 3-5 years – Delivery is projected to be at 15% of sales mix.

Technology – specifically Digital is fundamentally reshaping how consumers conduct shopping and purchasing of products of all types and yet there is no end in sight to where technology will ultimately take the consumer. But one thing is for sure, these new technologies are proving to exceed consumers expectations.

The future appears to offer even more complex abilities of inter-connections. Shopping will continue to be blended into everyday routines of anytime and anywhere.

OPERATORS' RESPONSES

We wanted to hear first-hand what operators had to say about Delivery. The points below highlight their opinions and experiences.

WHAT WE HEARD FROM OPERATORS:

- A survey of 1,000 restaurant operators, both chain and independents, reported the following:
  - 57% Offer Delivery.
  - 43% Do not offer Delivery (38% of these, plan on adding Delivery).
  - 54% Use 3rd Party Delivery.
  - 21% Use in-house Delivery.
  - 25% Use a combination – in-house/3rd Party.
  - 86% Reported Delivery as profitable.

- Currently, for every operators' concern, there are multiple solutions being created to address them.
  - The Loss of control over customer data can be resolved with the restaurant's own App that allows order for Delivery. Many restaurants are offering incentives to sign up for their specific Mobile App such as discounts, free appetizers or even free Delivery for the 1st order.

- On the other side of the operator's perspective, they are under more pressure to make a profit and drive sales. Issues like rising minimum wage and other expenses – majority of operators are looking for ways to increase revenues without physically expanding their business.

<u>Concerns for 3rd Party Delivery Companies:</u>

- Loss of customer data to 3rd Party and direct contact.
  - Hardware costs and clutter – multiple Pads, Printers
  - In-House labor scheduling; predictability
  - High 3rd Party fees
  - Peak hour service disruption
- Pain points need to be prioritized.
- System must be seamless for customers/operations.
  - Simplification of integration into existing system.

<u>Top Concerns:</u>

1. Costs/profitability
   a. Survey found 86% reported profitable 3rd Party Delivery.
   b. 75% reported sales are increasing (in 2016 9% of sales mix; 2019 16% of sales mix)
2. That Delivery is just a passing fad.
3. It takes away from Dine-In business.
4. Inability to maintain control of Brand standards, quality, service, experience, customer expectations.
5. No control of 3rd Party – speed, appearance, quality.
   a. 70% of complaints are incorrect orders.
   b. 65% of complaints are slower service.

Survey Sources: Foodby / Compass RCR

EXPERIENCES – What Happens in That Last Mile:

We conducted research and a survey in May/June 2019 to learn what 3rd Party Delivery experiences were like for consumers. Below are the results with many surprises.

General Reviews:

75% of 3rd Party Delivery orders have some type of issue.

72% of consumers prefer ordering direct from restaurants.

23% of consumers would choose product over brand. Choosing product over brand was explained by respondents this way: If the consumer wanted a burger and they were a fan of McDonald's and their Big Mac, but McDonald's didn't deliver, then a burger from anywhere over-ruled McDonald's Big Mac. Hence, the consumers craving superseded brand loyalty.

22% of consumers complained of long Delivery times – excess of 1 hour.

7% of consumers complained of long delivery times over 2 hours.

22% of consumers complained of very poor service/attitude from customer service hotline. Several of the complaints are interconnected to calls to the 3rd Party customer hotline. In general, the attitudes of the people on the customer service hotline was very poor; accepting no responsibility for errors, promising refunds (but rarely received).

14% of consumers complained of never receiving their order.

13% of consumers complained of order missing items.

8% of consumers complained order was cancelled by 3rd Party provider.

7% of consumers complained of no refund when order not delivered.

6% of consumers complained of receiving the wrong order.

6% of consumers complained of price/fees.

Several Noteworthy Surprises:

1. The amount of complaints (75%) were much higher than expected and a follow-up question – "Would you continue to use 3rd Party Delivery?" revealed over 81% stated yes; but will use another source.
2. The high level of complaints about the 3rd Party Delivery companies' customer service department.
3. The lack of complaints about order being cold; even with these excessive Delivery times (cold food was less than 1% of complaints) was shocking.

Conclusion:

The customer who uses and wants the convenience of Delivery will tolerate a higher degree of bad experiences in order to have the Delivery convenience. Bad service, long Delivery times, missing items are all acceptable and not a deterring factor for Delivery. Therefore, the convenience of Delivery is more important than typical expectations for a restaurant dine-in experience.

Sources: Compass RCR / Trip Advisor / Yelp / Trustpilot

CONCLUSION:

The Delivery business model is here to stay; however, the extent of its impact on sales could vary. The current restaurant model is under unprecedented pressure from many sides: to grow sales, make a profit, and maintain control over day-to-day operations. It faces a shrinking market space due to limited available space and increased expenses to expand, a fight for share of stomach with new and increased competition from C-Stores, grocery stores, food halls, and retail outlets – all vying for food sales. There are growing pressures on margins from higher labor expenses – wages and benefits, utilities, and real estate costs are rising. The labor pool is shrinking. There are restaurants that are forced to work understaffed for some of their shifts or even reduce their hours of operations, and consumers' increasing demands for more convenience, technology, and better experiences are unceasing.

There is no end in sight for these pressures, so alternatives need to be found. Coincidentally, there are suitable alternatives that offer solutions: Off-Premise dining – specifically Delivery. Delivery offers ways to maintain competitiveness, relevance, and control profitability amid these challenges.

Delivery sales growth over the last 4 years, coupled with consumers' usage, indicate there is a market for Delivery. Its rapid sales and traffic growth despite the experience issues are unprecedented. All the while, traditional restaurant traffic is declining, and traditional restaurant sales growth is minimal.

Even the Delivery Business Model is evolving. The current 3rd Party Delivery fees are not sustainable – operators are pushing back. The current level of service is not acceptable, the excessive delivery times for orders (over 30 minutes) cannot last, and the restaurant surrendering of customer data to 3rd Party Delivery companies is under pressure to change.

Restaurant owners/operators should prepare accordingly. There needs to be a balance between practical vs. profitable vs. sustainable. The ROI in all categories is to be the goal: in sales, profits, time, traffic, and Brand credibility. Nothing is to be done that hurts the Brand's DNA or heritage. The sales generated from Delivery must be marginally neutral at the very least.

The Pizza Industry has been in the Delivery business since the 1980s. They offer a realistic and practical model for successful adaptation of the Delivery business.

RESTAURANT DELIVERY FINANCIAL MODEL

Delivery is expected to have tremendous impact on increasing sales over the next several years. We have taken McDonald's franchise P&L to create a financial model demonstrating the effects of Delivery on revenue and profits at several levels. Trefis Team has estimated that over the next 3 years Delivery sales will increast total revenue to approximately 9% by the end of 2021 at McDonald's. Recently, McDonald's Corporation renegotiated UberEat Delivery fees to 15%; down from 30%.

SAMPLE FROM McDONALD'S FRANCHISEE (2017)						
Various Incremental Sales	2%		4%		9%	
• Total revenue (AUV)	$ 2,720,952	100.0%	$ 2,720,952	100.0%	$ 2,720,952	100.0%
Total operating income	$ 144,210	5.3%	$ 144,210	5.3%	$ 144,210	5.3%
• AUV breakdown average sales						
Drive-Thru	$ 1,801,862	65%	$ 1,801,862	65%	$ 1,801,862	65%
Dine-In	$ 554,419	20%	$ 554,419	20%	$ 554,419	20%
Off-Premise	$ 408,143	15%	$ 408,143	15%	$ 408,143	15%
		100%		100%		100%
• Breakdown of total Off-Premise sales 2019						
Take-Out	$ 353,724	13%	$ 299,305	11%	$ 299,305	11%
Delivery	$ 54,419	2%	$ 108,838	4%	$ 244,886	9%

• Delivery sales and expense breakdown - 30% Fees						
AUV Delivery sales	$ 54,419	100.0%	$ 108,838	100.0%	$ 244,886	100.0%
Labor	$ 15,782	29.0%	$ 31,563	29.0%	$ 71,017	29.0%
Food cost	$ 15,509	28.5%	$ 31,019	28.5%	$ 69,793	28.5%
Royalties	$ 2,177	4.0%	$ 4,354	4.0%	$ 9,795	4.0%
Delivery fees	$ 16,326	30.0%	$ 32,651	30.0%	$ 73,466	30.0%
Net profit/loss	$ 4,625	8.5%	$ 9,251	8.5%	$ 20,815	8.5%
• Delivery sales and expense breakdown - 15% Fees						
AUV Delivery sales	$ 54,419	100.0%	$ 108,838	100.0%	$ 244,886	100.0%
Labor	$ 15,782	29.0%	$ 31,563	29.0%	$ 71,017	29.0%
Food cost	$ 15,509	28.5%	$ 31,019	28.5%	$ 69,793	28.5%
Royalties	$ 2,177	4.0%	$ 4,354	4.0%	$ 9,795	4.0%
Delivery fees	$ 8,163	15.0%	$ 16,326	15.0%	$ 36,733	15.0%
Net profit/loss	$ 12,788	23.5%	$ 25,576	23.5%	$ 57,548	23.5%

Source: Kalinowski Research / Trefis Team

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