COMPASS™ RESTAURANT CONSULTING & RESEARCH

Restaurant Industry Summary Report // June 2022

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COMPANIES MENTIONED IN THIS REPORT:

CORE COVERAGE

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McDonald's	MCD	7
Burger King	BKC	8
Wendy's	WEN	9
Jack in the Box	JACK	10
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KFC	YUM	12
Del Taco	TACO	13
Taco Bell	YUM	14
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Domino's	DPZ	16
FAST CASUAL		
Chipotle	CMG	17
Starbucks	SBUX	18
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CASUAL		
Applebee's	DIN	21
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Chili's	EAT	23
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Longhorn	DRI	25
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INDUSTRY: HEADLINES / BUSINESS CONDITIONS/TRENDS

HEADLINE NEWS:

- Staffing issues rise slightly in June. Outlook for summer is challenging.
- Supply Chain issues looking to get worse – for Independents.

ECONOMIC HEADLINES:

- Inflation is dominating consumers concerns and increasing the negative impact on restaurants.

OPERATOR HEADLINES:

- Operator confidence is at a 48-year low.

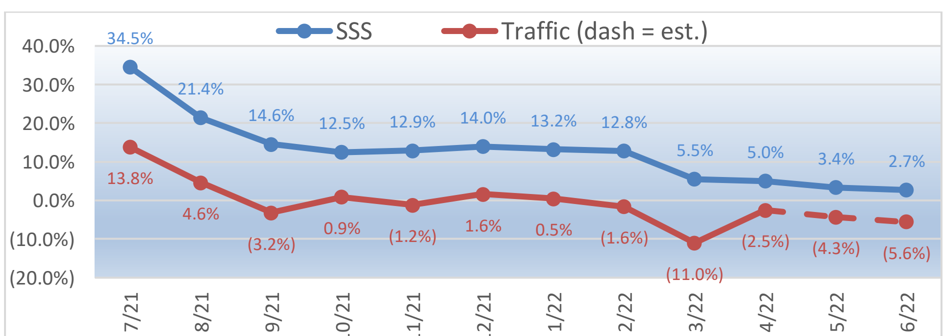
CONSUMER HEADLINES:

- Customer Loyalty Programs – becoming more critical as a sales driving force.
- Further indicator of consumers trading down – All Casual Dining concepts mentioned Pasta entrees as their top sales drivers. Pasta has a lower price point and enables the consumer to continue dining out as long as they trade down.

SALES & TRAFFIC: (Compass RCR coverage average):

Industry avg. SSS	+2.7%
Industry avg. Traffic	<5.6%> (estimated)

- SSS were positive.
- Traffic was negative. This marks a trend that goes back several quarters. It appears this negative Traffic trend will last throughout the year.



Please see Page 7 for Important Disclosure

ECONOMIC NEWS AND (BREAKDOWN):

- **Inflation dominates consumers concerns across all demographics and for the month was 8.6%.** Shrinking purchasing power is forcing many (especially lower income) to find new ways to stretch their dollars (we reported this shift in February 2022). This means value/money's worth is becoming a top priority. Consumers abilities and willingness to spend are challenged on multiple fronts. Poll after poll, survey after survey are reporting consumers personal financial situations are worse than hey were in January 2021.

  The PCE (Consumer Spending Index) reports spending at 3.1% annualized; which is a good number. So where is the disconnect? It appears that the higher income are continuing to spend and haven't pulled back. Lower income shoppers have pulled back. They are focusing on necessities and turning to cheaper items and/or less expensive stores.

  The Food at Home Index for May reported meats: beef, chicken , fish increased 14.2% over last year while eggs increased 32.2%, fruits and vegetables increased 12.6%, and gasoline is up 48%. A recent poll by Gallup found Americans are most pessimistic about their personal finances than any other time in recent history. 54% rated their personal financial situation as poor to fair while 48% say its getting worse.

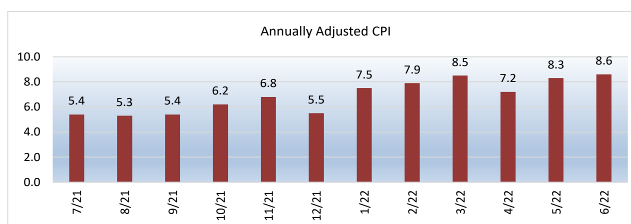
  For Restaurants: Inflation is causing pressure on prime costs (up 25%); forcing restaurants to pass some of these costs to consumers while taking a hit on their profit margins for the balance. A recent poll conducted by the National Restaurant Association (May 2022) found that 72% of restaurants fear they will be driven out of business if inflation doesn't moderate (keep in mind the majority of this poll consists primarily of Independent restaurants <u>not</u> Chains). 60% of these owner/operators stated the prevailing level of inflation poses more of a threat to their business than the pandemic.

  Staffing Issues: Typically, the summer months are when restaurants gear up their staffing levels. But, with the current staffing environment, this year is more challenging than others. With most businesses just beginning to regain most of their needed staffing levels, the fight for willing and able employees will be intense. Already many chains have reported summer hiring efforts well below pre-pandemic levels. Some operators have begun to adjust their hours of operations and are reclosing parts of their Dining Rooms.

- **Supply Chain Issues Update:** While major chains have been experiencing minimal issues in the last few months (primarily due to their buying power), many small chains and Independents, though stable for now, continue to experience occasional shortage of key ingredients from their orders. As summer has geared up, rumors of upcoming threats to multiple provisions has them on edge. The shortage of fertilizer due to the war in Ukraine impacts farmers ability to grow; along with diesel prices to name a few. The problem is worldwide. While efforts have been made to ease the transportation issues, the potential shortages of raw material won't be easily fixed.

- **Economic News (Breakdown) (source: BLS)**

CPI/Inflation Rate (Annualized)	8.6%
Commodities wholesale prices rose YOY (PPI)	10.8%
Unemployment	3.6%
Food at Home Index rose	11.9%
Food Away From Home Index rose	7.9%



SOURCE: TRADINGECONOMICS.COM US Bureau of Labor Statistics

NATIONAL GAS AVERAGE - PER AAA												
6/21	7/21	8/21	9/21	10/21	11/21	12/21	1/22	2/22	3/22	4/22	5/22	6/22
3.09	3.17	3.19	3.18	3.38	3.41	3.29	3.37	3.92	4.24/LA 6.03	4.12/1.74 2020	4.82	4.91

Gasoline was averaging $4.91 in June 2022. June 2021 it was $3.09. Some analysts are predicting $10 a gallon for gasoline before Labor Day.

WHOLESALE COMMODITIES UPDATE	June 2022	June 2021
Beef	$3.86	$3.07
Dairy	$2.77	$1.79
Pork	$2.95	$2.32
Poultry	$3.42	$2.77
Produce	$26.00	$19.50
Seafood	N/A	N/A
Chicken Wings	$3.65	$5.92
Thighs	$0.93	N/A
Basket (limited)	$6.22	$5.89

SOURCE: Commodities: USDA Market Report

Demand remains high for all food products but many food sectors are experiencing reduced outputs due to a myriad of circumstances. According to the USDA's latest report (June 24, 2022) food prices are expected to exceed the increases of 2020 and 2021. Food at Home prices are predicted to increase between 8.5% and 9.5% for the remainder of the year. Food Away From Home prices are expected to increase between 6.0% to 7.0%

Some key product predictions:

- Pork prices 7% - 8%
- Poultry prices 13% - 14%
- Beef prices 7.5% - 8.5%
- Seafood prices 8.5% - 9.5%
- Dairy prices 10.5% - 11.5%
- Fruits & Vegetables 7.5% - 8.5%

A reminder – this will impact consumers as well as restaurants.

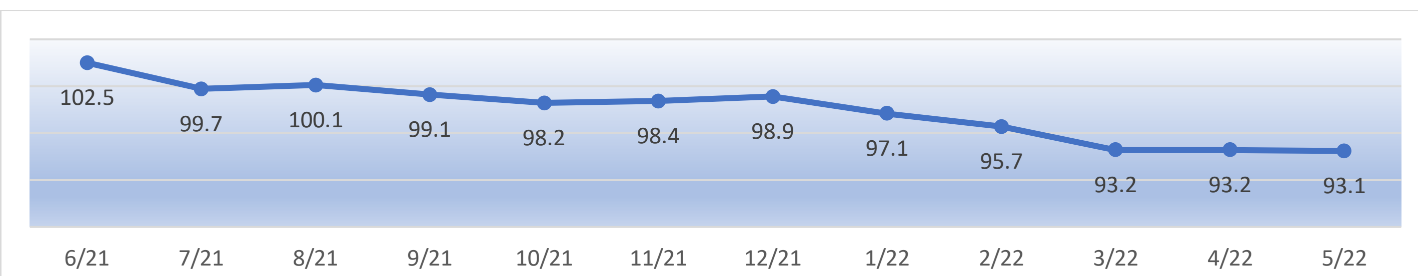
RETAIL COMMODITIES UPDATE	June 2022	June 2021	May 2022
Ground Beef	$4.89	$4.50	$4.89
Milk	$4.20	$3.50	$4.01
Bacon	$7.36	$6.36	$7.42
Bread	$1.61	$1.51	$1.61
Coffee	$5.84	$4.57	$5.53
Whole Chicken	$1.82	$1.49	$1.79
Eggs	$2.86	$1.62	$2.52
Potatoes	$0.88	$0.76	$0.85
Basket	$3.68	$3.04	$3.58

OPERATOR NEWS (BREAKDOWN):

- Current Month Sales (nationally):
  - 71.0% ⇧ Increase over last year
  - 20.0% ⇩ Decrease over last year
- Current Traffic:
  - 55.0% ⇧ Increase over last year
  - 31.0% ⇧ Decrease over last year
- Future Outlook for Business Conditions over the next 6 mos.
  - 48% expect business conditions to be worse
- Future Outlook for Sales:
  - 55.0% ⇧ Increase over last year
  - 16.0% ⇩ Worse than last year
- Capital Spending:
  - 57.0% ⇧ Equipment expenditures in last 3 mos
  - 49.0% ⇧ Expanded
- Future Spending Plans:
  - 48.0% ⇩ Plan equipment
  - 37.0% ⇩ Plan expansion
- Margins Impact:
  - 91.0% ⇩ Reported food cost increase (rose 7.2% YOY)
- Menu Prices:
  - 86.0% ⇩ Higher than LY
  - Menu prices increased 6.3% over last 12 months
- Staffing Issues:
  - 55.0% ⇩ Fully Staffed
  - 51.0% ⇧ Lacked Staffing to meet summer sales expectations

  According to NRA May Report, the restaurant industry continues to be understaffed by 750K (jobs available)
- Top Concerns:
  - 86.0% Recruiting/Retaining staff
  - 85.0% Food costs/product availability (inflation)
  - 77.0% Economy

SMALL BUSINESS OPTIMISM INDEX (Source: NFIB and Compass RCR)



This marks the fifth straight month below the 48-year average of 98%. Owners expecting better business conditions over the next 6 months decreased 4 points to a net negative 54%, the lowest in 48 years. Expectations for better business conditions have deteriorated every month since January. 28% reported inflation as the single most important problem in operating their business. 39% reported supply chain distractions have significantly impacted their business.

A recent survey by the Conference Board reported CEO confidence declined sharply worldwide; falling to 42. The survey gives a picture of how economic conditions are being perceived by CEO's.

RESTAURANT PERFORMANCE INDEX: (Source: National Restaurant Association)

	10/21	11/21	12/21	1/22	2/22	3/22	4/22	5/22
RESTAURANT PERFORMANCE INDEX	104.5	104.8	104.8	103.2	103.8	103.7	102.1	102.6
CURRENT SITUATIONS								
$ SSS Increase/Decrease	85%/11%	86%/7%	89%/11%	73%/21%	82%/16%	75%/10%	63%/24%	71%/20%
Capital Spending	62%	75%	48%	57%	69%	53%	60%	57%
EXPECTATIONS:								
$ Sales Outlook Improvement	50%	59%	67%	55%	61%	63%	49%	55%
Economy Outlook Improvement	30%	37%	40%	61%	29%	28%	20%	48%

CONSUMER SENTIMENT: (Source: University of Michigan Sentiment Poll)

	7/21	8/21	9/21	10/21	11/21	12/21	1/22	2/22	3/22	4/22	5/22	6/22
Consumer Sentiment	81.2	70.3	72.8	71.7	67.4	70.6	67.2	62.8	59.4	65.2	58.4	50.0
Current Economy	84.5	78.5	80.1	77.7	73.6	74.2	72.0	68.2	67.2	69.4	63.3	53.8
Consumer Expectations	79.0	65.1	68.1	67.9	63.5	68.3	64.1	59.4	54.3	62.5	55.2	47.5

These readings are the lowest on record for the University of Michigan Consumer Surveys which spans 46 years.

Inflation continues to be the paramount concern for consumers. A deeper look:

- 47% blame inflation for eroding their personal income/standard of living.
- Current Economic Conditions – Economic pessimism is growing as their expectations for current and future economic outlook deteriorates.
- 77% believe the economy is getting worse.

TOP CONCERNS:

	June 2022	May 2022	April 2022	March 2022	February 2022	January 2022
Anxious about personal finances/standard of living	96%	91%	86%	83%	82%	73%
Inflation impact on discretionary spending – reduced plans	92%	91%	91%	87%		
Dissatisfied with the way country/government is going	82%	78%	78%	78%	49%	38%
Health in general/ Covid concerns	29%	27%	39%	46%	44%	56%
Immigration	18%	22%	28%	35%	39%	41%

SOURCE: Gallup Poll

LOYALTY PROGRAMS RANKING: Recent poll conducted by Newsweek June 2022

Ranking	Restaurant	Score
1	Andy's Frozen Yogurt	9.73
16	Red Robin	7.82
17	Domino's	7.75
19	Burger King	7.70
21	Chili's	7.66
24	Chipotle	7.61
28	McDonald's	7.51
29	Starbucks	7.48
30	Pizza Hut	7.48
32	Wendy's	7.46
41	Taco Bell	7.12
46	Popeye's	6.91

Others in our coverage not listed: Jack in the Box, Wingstop, Noodles, Dine Brands, Chuy's, Darden.

Loyalty Programs are becoming an essential part of a restaurant's arsenal to drive sales. Since the reopening of the U.S. economy, most restaurant chains have launched new/or improved existing customer loyalty programs.

At Starbucks recent Earnings Call, CEO stated Rewards represent 53% of all store spend.

According to one study, the average household is enrolled in 18 different loyalty programs (this includes retail).

The challenge for companies is to get customers to sign up and offer enticing enough offerings (which include: (1) ease of use, (2) benefits, (3) overall satisfaction). For companies, they are learning there is a payoff to offering loyalty programs. Increased visits, higher purchases – check average spend, more allegence to the brand, just to name a few.

In the eyes of the customer, being easy to use (1 tap) plus benefits like free food offerings or discounts are the attraction they seek most. With inflation influencing how, where, and when the customer spends – a good loyalty program is a must.

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