U.S. restaurants: not-so-tasty takeaways

Eating out is at the heart of America's modern lifestyle. Prolifically knitted into the streetscapes of today's urbanized America, restaurants occupy an increasingly vital place in the country's broad economy. As an economy driven strongly by consumer expenditure, the consumer landscape provides valuable insight on the world's largest economy. Inevitably, restaurant businesses are at the coalface of consumer spending. This week, we comment on recent results from bellwether US restaurant companies, shedding light on the state of the country's consumer as the economy remains shadowed by recessionary fears.

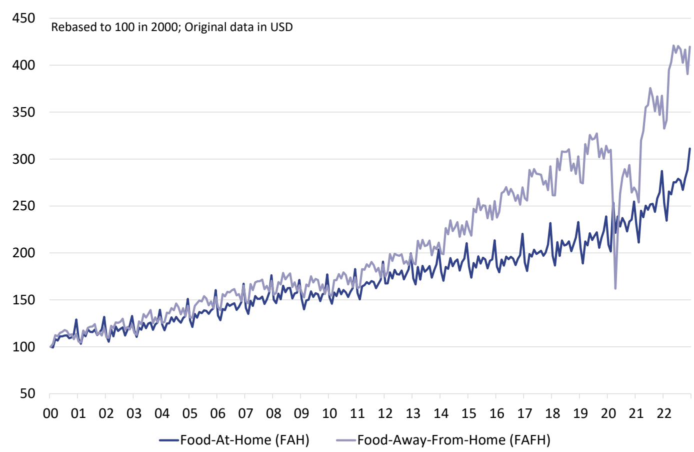
James Clarke

SPEED READ

- **Restaurants occupy an increasingly integral part of the US economy. Latest data from the U.S. Department of Agriculture reports that food-away-from-home spending accounted for 56% of the country's total food expenditures in 2022, up from 44% in 1987.**
- **For much of last year, the US economy performed more resiliently than expected. Recent data, however, has showed a lack of further progress in curbing inflation, leading to the sustained pressure of higher rates for longer.**
- **Recent results from bellwether companies within the restaurant industry reveal declining customer transactions as consumer pressures persist, prompting strategy shifts to attract customers.**
- **US consumers are becoming increasingly prudent with their spending. The risk remains that interest rates will stay elevated for longer than anticipated.**

Standing as a centerpiece of the 21st century American life, restaurants fulfill a crucial position in the country's economy. Interestingly, data from the U.S. Department of Agriculture (USDA) reports that food-away-from-home spending accounted for 56% of the country's total food expenditures in 2022, the latest data available, up from 44% in 1987. This showcases the population's propensity for the convenience of restaurant food, which has become an affordable luxury for many Americans. As an economy driven strongly by consumer expenditure, we follow developments within America's consumer landscape to glean insights on the world's largest economy. Following the end of the US reporting season earlier this month, recent results from the US restaurant industry provide important information on the state of the country's consumer as the economy remains under pressure.

US FOOD CONSUMPTION TRENDS



Food-away-from-home sales make up more than 50% of total food sales in the US as eating out has become an affordable luxury and a way of life for many Americans.

Regular readers will know that the US economy performed much more resiliently than expected last year. After intense monetary tightening to battle inflation, many braced for an economic slowdown. For much of the year, however, this slowdown did not materialize. Similarly, restaurant sales displayed strength during 2023, which transpired despite several quarterly warnings of weakened spending from low-income consumers. More recently, however, economic reports have displayed a lack of further progress on curbing inflation. As a result, the Fed's caution has been reinforced, leading to the sustained economic pressure of higher interest rates for longer. Consumer data now shows record-high credit card balances and low personal savings measures, which both underscore the increasing challenges facing consumers.

Within the food and restaurant industry specifically, the effects of inflationary pressures have been notable. Following the pandemic, food in the US became more expensive. This led restaurants to pass rising costs on to consumers through a series of sharp menu price increases. As a result, the portion of US consumers' income spent on food reached the highest level in three decades at 11.3% in 2022, according to the latest data from the USDA. Furthermore, data from the U.S. Bureau of Labor statistics now reveals a widening disinflation gap between restaurants and groceries. Simply put, inflation in grocery prices has abated faster than restaurant pricing over the past year, increasing the relative attractiveness of groceries in the current environment. Do inflation-anxious consumers still view restaurants as an affordable luxury?

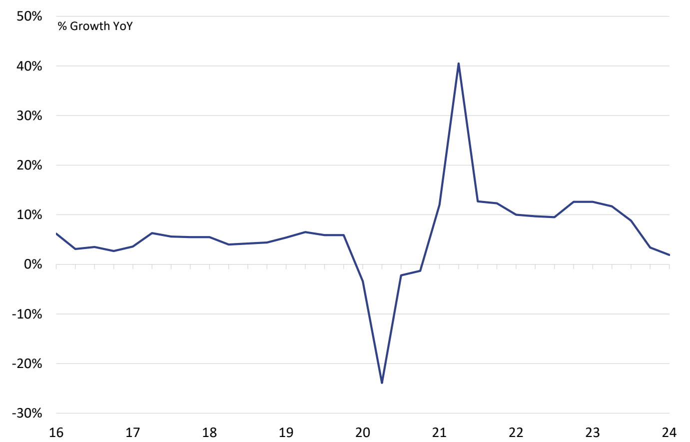
Recent quarterly reports from bellwether companies within the US restaurant industry, such as McDonalds and Starbucks, highlighted that consumers are becoming increasingly discriminating with every dollar that they spend. This pattern is supported by traffic growth figures from an index of quick-service restaurants, including McDonalds and Burger King, which have decreased for 30 of the past 32 months, according to Bloomberg. Inflation-weary consumers within lower-income brackets have restrained their spending, resulting in increased competition among restaurant brands for a smaller pool of customers. While this has been well anticipated over the past number of months, the depth of this recent pullback still caught some US restaurant executives by surprise.

KFC is ubiquitous across American towns, with the smiling Colonel's face greeting hungry consumers.

McDonalds executives stated that the macro headwinds have been more significant than expected coming into the new year. In recent quarters, McDonalds has reminded investors about the risk of slowing same-store sales growth in a more challenging macroeconomic environment, and this slowing growth has materialized. The company reported same-store sales growth of 1.9% for the first quarter of this year and expects a continued moderation in their top-line growth this year, as consumer pressures persist. McDonalds foresees that same-store sales growth figures throughout this year are likely to be below their historical average range of 3-4%.

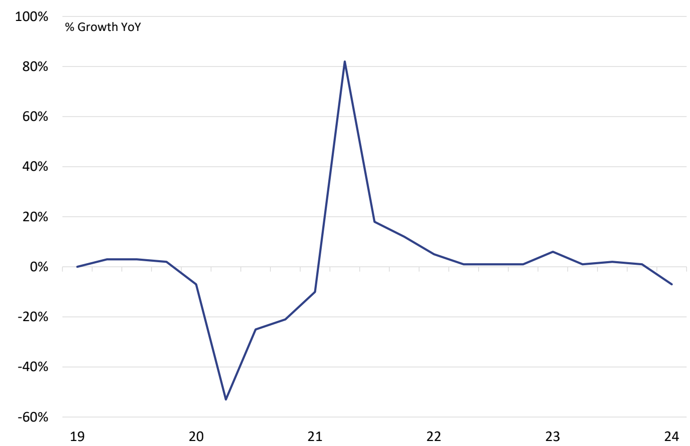
Results from Starbucks, the largest coffee company in the US, shocked investors by reporting a significant miss on estimates. The share price fell close to 16% after investors digested the company's disappointing results. Customer transaction numbers in the company's North American segment decreased by 7% on a year-on-year basis. Management ascribed this to unexpected pressures on the

MCDONALD'S SAME-STORE SALES GROWTH



McDonalds same-store sales growth has moderated over the past number of quarters and is expected to remain below historical averages of 3-4% for the remainder of the year as consumer pressures persist.

STARBUCKS N. AMERICA TRANSACTION GROWTH



Starbucks' transaction growth in the company's North American segment decreased by 7% year-on-year, highlighting the recent pullback from cost-burdened consumers.

company's occasional customers, causing them to visit much less frequently. Starbucks also announced revised guidance for the 2024 fiscal year. This revision of guidance figures comes consecutively after the company lowered their guidance previously in the prior quarter.

Other big fast-food brands are also struggling to reach consumers. Yum Brands, the owner of KFC and Pizza Hut, amongst others, reported results that aligned with those of its fast-food peers. KFC and Pizza Hut's same-store sales growth in the US declined by 7% and 6% year-over-year, respectively. On the other hand, the sit-down restaurant segment of the industry has also reported significantly suppressed customer traffic numbers, turning to promotions and advertising to limit the drop-off from diners.

"The recent results from US restaurant companies at the frontline of consumer spending reveal the consumer pressures being faced today."

The pullback from increasingly prudent consumers has prompted calculated shifts in the strategies of major players in the restaurant business. McDonalds, known as an affordability leader within the market, has emphasized an incremental focus on providing value to customers to drive traffic and sustain growth. The company purported to be "laser-focused" on providing value to customers with a more national message as opposed to locally isolated marketing efforts. On the other hand, Starbucks, a brand synonymous with premium, status-symbol coffee, has now obscurely reverted to accentuating a similar value message. The coffee chain announced that it will be opening its loyalty app for all customers in July this year, allowing the occasional customer group to see the brand's offers and value provided within the app's ecosystem.

The recent results from US restaurant companies at the frontline of consumer spending reveal the consumer pressures being faced today. US consumers remain pressured by persistent inflation and high interest rates, resulting in an increased prudence observed in their consumption patterns. The risk remains that interest rates will stay elevated for longer than anticipated. The US economy, and the many affected by it, continues to wait in suspense for the beginning of the rate cutting cycle.

Restaurants are densely woven into American neighbourhoods and urban areas, occupying a vital part of the country's broad economy

By the time of our next Insight seminar, our election will be out of the way. We will take the opportunity to review market performance for the first five months of the year, and look ahead to what the second half might hold.

Please note that we will be hosting both a morning and evening presentation in Cape Town. The venues will be communicated once finalised.

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Topic:	**Taking Stock: Mid Year Update**
Natal Midlands	
Date:	20 June, 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	11 June, 2024
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	13 June, 2024
Venue:	SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor
Time:	7.30am
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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