Real Challenges. Real Solutions.

How Restaurants Should Position for Success in the Post-Pandemic World

By Mark Samson and Charvi Gupta

In this article we take a look at the many unique challenges facing the restaurant industry and specific action steps that operators can take now to help them not only survive, but thrive, in the coming year and beyond.

Take a walk around in your city or town and you will find a range of shuttered restaurants. In 2020, restaurants reassessed their strategies, portfolios, and formats. While many responded rapidly and creatively, adapting to change using technology and innovative concepts, others failed. Several small- and mid-sized operators took advantage of the SBA's Paycheck Protection Program (PPP). The stimulus worked for those who were able to use it purposefully; for others it quickly ran out. This also let zombie companies or companies with unviable business models continue to operate. Data from foodservice research firm Datassential indicates that approximately 10% of U.S. restaurants closed permanently during the COVID-19 pandemic. Urban areas were hit even harder, with food suppliers fearing that more than 20-30% of their urban restaurant clientele had closed shop. In New York City itself, according to a CNBC report, restaurant seating decreased by 50% compared to pre-COVID levels. A few key restaurants continued to boom in residential areas of the city based largely upon social media and influencer exposure.

The challenges facing restaurants are significant and likely to continue into 2022 and beyond. They include:

Landlord and lease issues
The importance of the relationship between operators and landlords has increased significantly since the pandemic. Many restaurants lack sufficient cash flow or access to additional working capital to pay some or all their rent and may be in violation of operating covenants and other non-monetary obligations under their leases. Although the extension of the eviction moratorium is helping certain tenants, it is a temporary fix. Some operators have leases that are not realistic today, especially in urban areas. In most cases tenants cannot litigate, as there is truly no defense. Frustration of Purpose has been tried, and in most cases failed.

Increasing labor costs and inability to find workers
Unemployment benefits, stimulus payments, lack of benefits, long hours and stressful work are some of the reasons that many restaurant workers have quit the industry. While some states already have a $15 minimum wage, in other states the demand/supply imbalance has pressured wages upward. Restaurants are understaffed, and employees are working longer hours. Many restaurants, even with the sudden surge resulting from pent-up demand, can be seen with closed-off sections and a "Help Wanted" sign. They are offering sign-on and recruitment bonuses, upgraded benefits, child-care, college tuition, and more in a bid to get workers. This has made labor not only expensive but difficult to acquire and to retain. An additional contributor to labor shortages is vaccine hesitancy, as many restaurants are trying to do what they believe

is the right thing for their customers and employees.

According to NRA, July marked the seventh consecutive month of staffing growth, translating to a net increase of 1.3 million jobs in the first half of 2021. Despite these increases, restaurants remain nearly 1 million jobs or 8% below pre-pandemic employment levels. In fact, 75% of restaurant operators reported that recruiting employees was their top challenge as of June 2021 — the highest level ever recorded.

The full-service segment was down 626,000 jobs, or 11% below pre-pandemic employment levels; the limited-service segment was down 175,000 jobs or 4% in the same period.

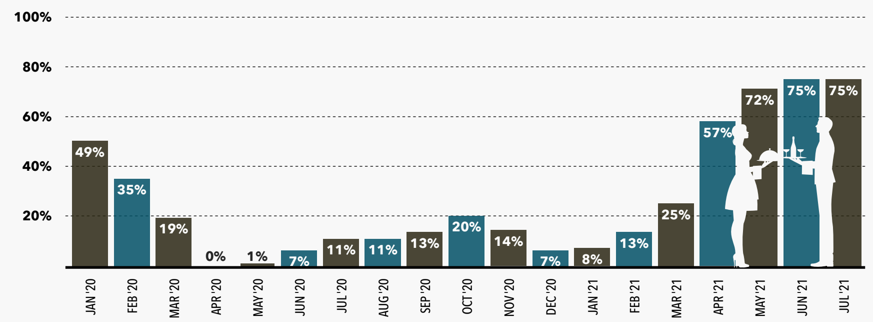
Food inflation

With national supply chain problems, a lack of skilled labor, high shipping costs, shortage of shipping containers, high commodity prices, as well as the rising demand post COVID-19, food prices have risen. According to the Bureau of Labor Statistics, in July 2021, consumer prices rose 5.4% year-over-year. Separate data from the U.S. Department of Agriculture shows that year-over-year wholesale prices for poultry are up 50%, while wholesale boxed-beef prices increased by 30%. The pressures of the tight labor market and higher food costs have caused menu prices to increase 3.9% on a year-to-date basis through June. Getzler Henrich anticipates that menu prices will need to be much higher for desired 4-Wall EBITDA to be achieved.

Pressure to innovate and differentiate to stay competitive

Dynamic operating requirements like environmental regulations and new technologies had already created new challenges for businesses. With the pandemic's capacity restrictions and outdoor dining mandates in place, dramatic changes in consumer behavior have put further, significant strain on operators. It has been challenging to be creative in these difficult times. Developing innovative business ideas to navigate these challenges and ensure survival only increases the pressure.

Hiring Talent - Top Challenge

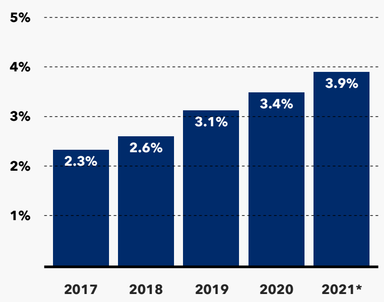


Source: National Restaurant Association Industry Tracking Survey

Restaurant and Foodservice Industry Food and Beverage Sales: 2019 to 2021	2019 SALES (billions)	2020 SALES (billions)	'19-'20 % CHANGE	2021 SALES (billions)	'20-'21 % CHANGE	'20-'21 REAL % CHANGE
EATING & DRINKING PLACES	$615.9	$497.6	-19.2%	$609.0	22.4%	18.4%
Full Service Segment	$285.0	$199.5	-30.0%	$255.0	27.8%	24.2%
Limited Service Segment	$308.9	$290.4	-6.0%	$339.0	16.8%	10.5%
Bars & Taverns	$22.0	$7.7	-65.0%	$15.0	94.8%	91.3%
All Other Foodservice Establishments	$248.4	$166.5	-35.0%	$180.0	11.5%	8.0%
TOTAL	$864.3	$659.0	-23.8%	$789.0	19.7%	15.7%

Source: National Restaurant Association Note: Figures do not sum precisely due to rounding

Menu Prices Inching Higher



*Source: BLS. * Year-to-date thru June*

Actions Steps to Thrive

4-Wall EBITDA assessment

This assessment analyzes contribution by location. It does not include corporate or regional support overhead charges, head-office labor, etc. and is generally defined as "revenue less the direct expenses of operating each location." Comparing the performance of each location helps operators differentiate between healthy and poorly performing stores.

For poor performers, additional analysis should be undertaken to understand the underperformance and discern whether the issues can be corrected with minimal effort or should be closed. Is poor performance

Targeted EBITDA

Revenue	**100%**	Net of Sales Tax
COGS (food)	26%	Magic number is 25%
Consumables	5%	
Payroll BOH & FOH	34%	Wage inflation is rife
Occupancy	9%	Depends on urban or non-urban
Other	6%	Marketing, R&M, et al.
COVID-19 costs	2%	1-2%
Operating Costs	**82%**	
4-WALL EBITDA	**18%**	

4-Wall EBITDA should take care of corporate, administrative and regional support

a traffic issue, a rent issue, a menu mix issue, or a labor issue? Once known, corrective action can be taken. Operators need to make sure they have addressed all operational issues before approaching the landlord for relief. Many times, landlord mall managers know which restaurants are not performing because of the restaurant's own inefficiencies, marketing, bad service, et al. If 4-Wall EBITDA is below targeted levels despite landlord cooperation, reduced operating expenses, labor at market levels, and efficient food purchases, then raising prices should be the next step.

But what should the targeted 4-Wall EBITDA be? It depends. According to Getzler Henrich estimates, targeted EBITDA should be between 15-18% of revenue. Franchisees have a higher target of approximately 18% of revenue as they need to account for royalties, whereas other restaurant formats that do not need to pay royalties might choose to target a lower 4-Wall EBITDA in the 15% range. The "magic" 18% targeted EBITDA number is based on the fact that owners have corporate administrative expenses and desire a profit margin of at least 10%.

Cost management

According to a recent CNBC report, the average asking rent-per-square-foot for commercial real estate in the U.S. has dropped by 8.75% over the past year. Some landlords are giving new tenants a percentage of rent contracts that have claw backs, should activity return to normal. As such, it is important for restaurant operators to negotiate with their landlords for terms and conditions that reflect the current operating environment. These negotiations could involve making concessions such as temporary or long-term abatements, or newly structured partnerships. While some landlords let tenants walk off, most prefer to negotiate a solution, keep the tenant and not incur the cost of empty locations, relisting, broker fees, etc.

It is not only important to have strong relationships with key suppliers, but also to expand vendor relationships and search for new partnership opportunities to ensure that restaurants can get the best deals and stay ahead of the game. By centralizing supply chain controls and using automated processes for inventory management, restaurants can address supply chain disruptions and challenges in a cost-effective manner.

Sometimes, costs are high because waste is high. By measuring the waste weight of each shift (or day), recording as well as analyzing it to see productive and non-productive kitchen members (or days), restaurants can focus on waste reduction and lower costs. Additionally, unapproved store purchases and distributor substitutions should be immediately flagged and addressed to achieve greater cost control and consistent product quality. Just looking after the bad inventory makes sure that the good inventory looks after itself!

Sometimes, shrinking menus makes sense especially when most of the sales come from a small portion of the menu. By analyzing demand patterns, operators can eliminate unpopular items to streamline and have leaner and simpler operations. The fact that this also makes it easier to train new employees is an added benefit. The result, overall, is less waste and better economies of scale.

Pricing optimization and menu mix

Operators normally raise prices twice a year based on CPI and seasonality. Some refrain from increasing prices for fear of losing customers. However, an optimal price and menu mix is imperative for increasing ROI.

Getzler Henrich recommends micromanaging prices up and down across the supply chain. If there is substantial customer demand for a restaurant, a good time to increase prices is when costs have gone up already or when restaurants are expecting wholesale prices or fixed costs to rise. Another good time to increase prices is when larger restaurants and chains have increased their prices, or certain commodity price increases are featured on regional or national news. During the pandemic, major chains' CEOs were constantly appearing on TV, discussing food inflation, labor shortages, landlord issues, unvaccinated employee policies, etc. Operators should take advantage of this information to raise prices. Having said that, pricing is sensitive, and restaurants must balance the effects of price increases. Servers and GMs should be armed with good information on reasons for increases.

Furthermore, operators should set prices of each menu item individually, by analyzing plate costs, estimating the price range customers are willing to pay through an analysis of competitor prices, and analyzing factors that influence customers' value perception of the item. A good way to soften the effects of price increases is to re-engineer the menu, which involves repackaging items (removing salads or sides) or implement well-orchestrated portion controls that enable customers to see value for money. Other approaches include retaining off-menu offerings (available to loyal customers on request but not on the menu) and introducing new, seasonal, and special/premium items.

Marketing and promotional effectiveness

A well-thought-out loyalty plan and social media marketing strategy can help operators know their customers and attract additional customers. Refreshing brand strategy, from the logo design and imagery to the way the restaurant speaks to its audience, is important for continued success. The next step is to open accounts on social media and populate them with useful information such as location, hours, description, menu, reservations, and so on. Once these basic pages have been set up, managing daily interactions, promotional and new product posts, and special events in a way that resembles real-life conversations will ensure that the audience is receiving adequate attention and engagement, leading to a successful marketing strategy. Additionally, gift cards are a wonderful source of funding. Approximately 12 to 15% of gift cards go unused. A chain that sells $1 million a year in gift cards can end up adding $120K to the bottom line.

Refreshing brand strategy, from the logo design and imagery to the way the restaurant speaks to its audience, is important for continued success.

Innovation
In this cut-throat environment, it is imperative for restaurants to innovate constantly.

- Consider a multi-channel approach: While takeout, delivery, subscriptions, and meal-kits are ways to develop multiple sources of revenue, restaurants need to have a planned approach and rethink strategy, product, and operations.

- Cost-effective deliveries: To avoid delivery fees charged by third-party delivery platforms such as Uber Eats and GrubHub, operators can assume ownership of the delivery process themselves. That does sound like a tedious process but with the help of companies such as Lunchbox and BentoBox, operators can develop, manage, and market their own online ordering platforms as well as get connected to delivery people. Most of these companies bill a small monthly charge for their work instead of restaurants having to pay exorbitant commissions to third-party apps. Furthermore, restaurants can have a direct line of communication with customers, helping them to promote future offer or correct a mistake with a previous order.

- Digitization of supply chain: Automation of both back-of-house (BOH) and front-of-house (FOH) is essential to streamline operations, establish controls and overall efficiency. From inventory stock-outs or surpluses, ingredient substitutions and shifting purchase orders, to delivery patterns and unpredictable consumer traffic, implementing comprehensive inventory management software ensures that products are on hand and on order. Additionally, by employing computer or app-based scheduling systems, operators can help increase labor efficiency and, thus, decrease costs. A modern POS system can assist with cost-effective operations by automating and managing payments, P&L management, ordering, reordering and vendor management in a low-cost and streamlined manner. Menu pads and self-service have already been adopted by many restaurants as an additional step to lower labor costs. Finally, with digitalization, the data that is gathered should not be siloed but, rather, extrapolated and analyzed for cost reduction and revenue boosting opportunities.

Operators should address all operational issues before approaching their landlord for relief.

- Multi-brand shared kitchen model: While delivery became the lifeblood of many restaurants during the early pandemic, ghost kitchens are now the new trend. Through the ghost-kitchen concept, with no brick-and-mortar presence, the restaurant only has a digital footprint. With a few BOH staff preparing food and fulfilling online orders, these kitchens can drastically reduce the costs of operating a full brick-and-mortar restaurant. For operators with strong brands, especially chains, as well as start-ups that have little minimal capital, these kitchens are great low-risk, low-capital models.

Closing Locations
If the steps outlined above do not improve cash flow and profitability, closing stores might be preferable to bleeding cash. In determining which stores to close, an operator should consider whether the units to be closed are single entities or under a corporate umbrella. Depending on guarantees, if it is a single entity, the operator can just close the store and walk away. "Good guy" clauses, extremely popular in New York, provide an exit right clause giving three to six months' notice if the tenant is in good standing. There is normally a personal guarantee attached to this. With multiple stores owned by the same parent, the operator should compare the cost of closing unprofitable stores with filing a Chapter 11 or the new Subchapter V bankruptcy. While Chapter 11 bankruptcy can be a costly affair, Subchapter V is a cheaper way of restructuring for smaller companies. Chapter 11 is a cost-benefit calculation: weighing the costs and the benefits of being able to renegotiate leases and rejecting bad leases.

Distressed, troubled or under-performing companies face challenges on multiple fronts. Getzler Henrich brings strong restaurant and other industry expertise coupled with an extensive track record in financial advisory services. Companies turn to us for help with turnarounds and workouts, interim and crisis management, bankruptcy advice, and financial restructuring. Need assistance? We are here to help.

With the help of companies such as Lunchbox and BentoBox, operators can develop, manage, and market their own online ordering platforms as well as get connected to delivery people.

MARK SAMSON
Managing Director
Getzler Henrich
(a Hilco Global Company)

He is a veteran of more than 30 years in both crisis management and operations, and has worked with both U.S. and foreign retail, distribution and manufacturing companies. Mark's areas of expertise include operations restructuring, business plan analysis, performance improvement, cash and vendor management, bankruptcy consulting and interim management services. Over the past 20 years, he has served as Interim CEO, CRO, president or financial advisor for more than 140 companies in the United States.

Mark's expertise stems, in part, from having founded a specialty retailer that became the largest in that industry, and also from having served as chairman of the audit committee and lead independent board director of a NYSE public company, which was the largest vertical clothing manufacturer in the United States with 280 retail stores in 19 different countries. He has significant composition (out of court), Chapter 11 and Section 363 experience. Mark has been involved in the retail food and apparel industry for more than 30 years. Since COVID-19, he has restructured several high-end apparel and restaurant concept rent leases. Mark led the team restructuring Diesel Jeans USA, taking them in and out of bankruptcy in 38 days, and winning the 2019 M&A Award for Deal of the Year under $100 million. In 2021 Mark and his colleague, as advisors to the syndicated lender group, won the M&A Award for Deal of the year between $100 and $250 million for Rubies Costume company.

Mark has significant board experience, and currently serves on several boards. In the past, he served on the board of a joint venture between an emerging market government, private enterprise, and the World Bank. He holds a B.B.A. in Economics and Marketing from the University of South Africa and is a member of the TMA and ABI. Mark has been published in the NY Law Journal and Franchise Enterprise magazine. Contact Mark at (212) 697-2400 or msamson@getzlerhenrich.com

CHARVI GUPTA
Associate Director
Getzler Henrich
(a Hilco Global Company)

She joined the company in 2017, and has over eight years of experience across M&A, corporate turnarounds, financial and operational restructuring and bankruptcy situations, where she has focused on transaction execution, due diligence, financial modeling and data driven analysis. Charvi has also worked with companies to address liquidity issues, develop cost reduction plans, implement process improvements, and improve profitability. She has worked extensively in the restaurant and retail space, having been involved in the Chapter 11 bankruptcy of Seasons Grocery as well as dissolution of Four Seasons Restaurant, Cosmoledo (Maison Kayser) and Milly.

Previously, Charvi was an Investment Banking Associate at MTS Health Partners in New York, working on M&A and private placements in the healthcare industry. Prior to that, she was an Investment Banking Analyst at Deutsche Bank in Mumbai and Hong Kong, where she focused on M&A, debt and equity transactions in the consumer and retail space. She also worked in project finance at Reliance Infrastructure in Mumbai.

Charvi has been a member of the Turnaround Management Association's New York Chapter and serves on the Network of Women committee. She is also a part of International Women's Insolvency and Restructuring Confederation's New York Chapter and serves on the Substantive Events committee. Charvi is also a member of the American Bankruptcy Institute. Charvi holds an MBA from Columbia Business School, an MS in Finance from the University of Rochester and a BA in Economics and Statistics from St. Xavier's College, Mumbai. Contact Charvi at (212) 697-2400 or cgupta@getzlerhenrich.com