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더 가깝고, 더 글로벌하게

FEATURE_ 특명! 호텔을 밝혀줄 '채널' 확보하라

HOTEL ISSUE_ 제2의 서막, 코로나 구조조정

FOCUS ON_ 내국인 공유숙박 제한적, 한시적 허용

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HOTEL INDEX_ 서울시내 자치구별 호텔업 등록 현황

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What's Wrong with the USA Restaurant Industry?

Through June 2020, there have been 530 restaurant group bankruptcies, the most of any industry in the USA. They are a mixture of regional franchisee groups as well as direct owned & franchisor brands, and the trend will only get worse into the second half of the year.

Just last month, NPC International, a mega-franchisee with 1200 Pizza Hut and 400 Wendy's restaurants entered into Chapter 11 proceedings. Other recent cases are Chuck E Cheese's, Garden Fresh Restaurants, the USA subsidiary of Le Pain Quotidien, Food First Global Restaurants (Brio & Bravo), and a large IHOP franchise group(CFRA Holdings).
Restaurant groups in the UK are facing similar challenges. The KKR backed Casual Dining Group, Jamie Oliver's Italian, burger brand Byron, and Carluccio's are just a few of the well-known brands undergoing the same fate across the pond.
It is important to note that the majority of the groups filing for bankruptcy or looking at financial reorganization of some kind are independent fast causal or full-service restaurants with a large dine in component. Many QSR chains with large numbers of drive-thru lanes are actually doing quite well and brands like Taco Bell & Wingstop are enjoying positive same store sales growth even during COVID-19.

It should also be noted that bankruptcy can be a positive thing as it often leads to a leaner healthier company. Acquisitions and sales during bankruptcy are also common. Moreover, bankruptcy gives a company the opportunity to terminate leases of poor performing stores.

However, there is a dark side to bankruptcy that I wish to explore here. Many of the restaurant groups in financial trouble today were perfectly good businesses but unfortunately took on far too much debt by their private equity owners.
Restaurant chains are too often viewed by the professional finance community as "cash machines" with no care given to the quality of the food or the welfare of the team members. It is not uncommon anymore to see total debt to EBITDA ratios of 5 or more which is

extremely dangerous to the financial health of any business. Same store sales declines of 10% or more can lead any restaurant or retail industry into distress if debt levels are too high, which is the case now with COVID-19.

PE backed California Pizza Kitchen (CPK) has recently missed two loan payments and is trying to avoid bankruptcy by seeking a $30 million bridge loan. Part of the excess debt was a result of the PE Fund wishing to take cash out of the company in the form of dividends. The PE Fund gets it money out but the restaurant group and employees are faced with bankruptcy and job losses. This certainly does not seem like a very defensible practice unless one is only interested in financial engineering.

Of the top 200 largest franchisee groups in the USA, a significant number of them have taken investments from Private Equity. This is often an attractive option for business owners who have the ability to get their cash out of the business and invest it elsewhere or distribute it to family members. In addition to this, many owners also look at sale leasebacks whereby they sell the land under their restaurants and then lease it back for 20 years at a fixed rent. Real Estate Investment Trusts (REIT's) often buy these syndicated deals given the potential yield. In a zero or negative interest rate environment, a yield of 4-5% looks very good to investors like pension funds or University endowments.

However, during COVID-19, many of these full-service restaurants cannot pay their rent given that their sales may have declined by as much as 50-60%. These commercial real estate trusts therefore, cannot pay their investors as well.
Excess leverage and sale leasebacks can generate higher financial returns in good times but there are nuclear bombs when times turn bad. Bond holders, real estate investment trusts and restaurant employees all suffer but private equity in many cases has already taken sufficient steps to protect itself from the coming pain.

The majority of restaurant chains in the USA have underinvested in their facilities over the past 10-20 years and it is readily apparent to any diner. I include all the big brands like McDonald's. KFC, Burger King, Pizza Hut, etc. in this category. It is also no surprise that family owned brands like In N' Out Burger, Chick-Fil-A, and Raising Canes are enjoying record sales and long lines at the drive thru. They pay higher wages and get better people and keep their facilities in top shape. They have excellent food quality and service and are less concerned with short term financial performance.

The USA restaurant industry will be far better off when owners focus more on the basics of making good food and taking care of customers and less on financial engineering. They are rarely compatible especially in tough times like today.
COVID-19 will tear through this industry like a forest fire and leave enormous destruction in its path. There will be far fewer independent restaurants in local communities and many more bankruptcies. While certainly not the only cause, professional financial investors have certainly added gas to the fire while perhaps not lighting the match directly.