RESTAURANT SALES UP 1.8% AND 1.9% IN NOV. & DEC. - WHERE TO NOW??

Date : January 18, 2018

RESTAURANT SALES UP 1.8% AND 1.9% IN NOVEMBER & DECEMBER – WHERE TO NOW??

I attended the well attended ICR Conference in Orlando last week and listened to restaurant companies, public and private, present their stories over the course of three days. Some reports have been positive but I read the tone as subdued. While customers are feeling more job security than in the recent past, translating to “gains” in same store sales, and operators are more constructive in terms of operating initiatives and expansion possibilities, I call the improved attitude a “relief rally”. As a country western tune put it “Down so far, down looks like up to me.” My view, probably in the minority right now, may well prove to be overly cautious, but here are a few supporting facts.

Just because the economy has demonstrated real GDP growth of 3% or so over the last six months of ’17, it does not necessarily follow that this strength will continue. Q2 through Q4 of 2010 averaged 3.0%, Q3 and Q4 of 2013 were 3.1% and 4.0%, and Q2 and Q3 of 2014 were 4.6% and 5.2%, none of which lasted. However, I’ve said many times that the restaurant industry has proven to be a leading indicator for the economy as a whole, so perhaps November and December restaurant industry “strength” is a forerunner of continued economic growth.

Here’s the problem, and these statistics have been provided by David Rosenberg, the highly respected economist and stock market strategist. Over the last several months, the consumer savings rate has been drawn back down to 2.9%, a decade long low, from 3.7% a year ago and 6.1% only two years ago. At the same time, consumer credit balances soared at a 10.4% annual rate (up $8.3B) in October and a 14.1% annual rate ($11.2B) in November. Over the last four months, $30B of consumer spending has been financed by credit card debt (up 9.3% annualized), as Rosenberg puts it: “a binge we last saw a decade ago, and we know how that turned out”. Rosenberg also points out (1) that household debt service and rent payments now absorb close to 16% of household after tax income, which would be a six year high. (2) the delinquency rate for motor vehicle loans has climbed to their highest level since October 1011 (3) The average interest rate on over $1T of credit card debt is up 50 basis points in the last month, a $50B hit to consumers, the latest rate above 19% for the first time in five years (4) the delinquency rate on all personal loans is almost at 2%, a four year high, and a significant rise from 1.5% just six months ago. All of this supports the view that while the unemployment rate is down to 4%, lots of jobs are part time, wage rates are stagnant, and consumers are financially stretched out.

The question then becomes, how strong are the restaurant sales, and can they continue if consumers are financially strapped? The answer is: restaurant sales are only “strong” relative to the even worse trends of the last couple of years. The sales, up 1.8% and 1.9% in November and December, do not account for the price increases that have negated the sales increases. Traffic and Transactions have in turn been flat, or worse, at almost all reporting chains. Add to the equation that 95% of restaurant chains are leaning heavily on value oriented promotions. Led by McDonald's with their $1 through $5 specials, Burger King with 2 Whopper's for $6.00, Wendy's with 4 for $4, the various boxes or buckets for $5.00, Taco Bell's $1.00 offerings, anybody selling lunch for more than $5.00 or dinner entrees for more than $10.00 has a real challenge.

We don't know whether real GDP growth can be sustained at 3% (or better) or not. We do know, however that the "better" (but NOT MUCH) restaurant spending trend has been financed by consumers running down their saving rate and running up their credit card debt (with higher interest and default rates). The restaurant sales and traffic trends will likely continue to look firm, but the comparisons continue to be very easy versus the negative trends in the Q1 OF '17. The average ticket at restaurant chains will be under pressure with the myriad of "value" offerings. Store level margins will be almost impossible to improve, with higher labor, higher rent, flat to higher cost of goods, and sluggish traffic. Sustainably better sales (and traffic) trends may establish themselves over time, but we doubt that it will be over the next several months.

Roger Lipton