Nation's Restaurant News

What the restaurant business can expect in 2015

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The restaurant industry looks poised for higher sales and profits in 2015, thanks to falling prices for gas and food and an economy that finally appears to be accelerating after years of painfully slow growth.

The profits should keep elevated the values restaurant chains can fetch on the public markets, which should continue to provide incentives for companies to go public while limiting the number of leveraged buyouts.

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That doesn't mean that buyers will shy away from the industry, as a merger-and-acquisition market fueled by low-cost debt should continue to generate plenty of buying and selling. Don't expect, however, anything along the lines of the $11.4 billion purchase of Tim Hortons Inc. by Burger King Worldwide Inc. that stood as the hallmark of 2014.

These are the conclusions of various experts Nations Restaurant News interviewed as the industry looks ahead to 2015. Taken together, predictions point to an industry in growth mode, but not one without risks in the new year.

Improving sales

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Many observers believe the industry could see strong sales growth in 2015. The only question is how much.

Larry Miller, co-founder of the NRN-MillerPulse restaurant tracking survey, said that annual restaurant same-store sales should finish at an increase of 1.8 percent in 2014. He's expecting just over a 2-percent increase in 2015.

The biggest difference between the two years? The comparisons are easy in January and February of 2015, because sales were terrible those two months this year thanks to difficult winter weather across most of the U.S. Still, easy comparisons aside, Miller also anticipates that guest traffic will increase next year, albeit slightly.

"Are trends getting better? Yeah," he said. "Is it a slow trip? Yeah."

That 2-percent same-store sales prediction is similar to some other prognostications. The debt rating agency Fitch Ratings, for instance, expects restaurant industry same-store sales to increase an average of 2 percent to 3 percent in 2015, with slight growth in guest traffic. And Chicago consulting firm Technomic is forecasting a 3-percent growth in same-store sales for the restaurant industry, though that's an early figure and could well be revised, the company said.

Put simply, many expect moderate growth.

The restaurant industry is largely saturated in the U.S., and there are many other dining options for those who don't want to cook at home — convenience stores, pharmacies and grocery stores have each beefed up prepared food options. Ikea and Costco operate lucrative restaurants within their giant retail outlets.

"I'm not sure [in the] next five years that we'll see a gangbusters year," said Darren Tristano, executive vice president at Technomic. "We'll have slow to moderate growth."

Still, lower gas prices should provide some fuel for the industry, as consumers will have a bit more money in their pockets after filling up. Brad Swanson, head of restaurant investment banking for KeyBanc Capital Markets, estimated that lower gas prices should be like an $800 annual stimulus per family.

Lower gas prices might already be affecting restaurant sales. Mark Kalinowski, securities analyst at Janney Capital Markets, said the fourth quarter is turning out to be the best quarter of 2014 for domestic restaurant same-store sales.

"The reason is simple," he said. "Over and over we hear from operators that, whenever their customers go to fill up their truck, it used to cost $60, now it costs $40. They go home and tell their wife and children, 'We're going out to eat.'

"You only need a little bit of your customer base saying that for it to have an effect," Kalinowski said.

Lower commodity costs, higher labor

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Rising sales might also come at a time when food costs are falling.

The costs for many commodities — cheese, chicken, wheat, pork and others — are expected to come down in 2015, after spiking in 2014, thanks to lower prices for corn used in feed and gas used for transport, according to Denver-based food cooperative SpenDifference. The exception is beef, which is expected to continue a run of record high pricing for at least two more years. In 2015, beef cost is expected to increase between 4 percent and 8 percent.

Even with that continued surge in beef, most chains could offset that uptick and still lower overall food costs in 2015, said DeWayne Dove, vice president of risk management at SpenDifference. Cheese, for instance, was up almost 19 percent in 2014, and is expected to decrease 23 percent in 2015.

Dove said his company's brands should see decreases in their total food costs of between 1 percent and 2 percent. Among those that serve a lot of beef, total food costs are expected to be flat from 2014.

Still, while food costs may decrease, higher labor costs in 2015 could offset that gain, as rising minimum wages in many states and the Affordable Care Act take center stage next year.

"A lot of smaller and mid-sized chains are just now coming to grips with the impact of the ACA on their financials," said Dave Schnitt, CEO of IQ BackOffice, which automates back-office functions for many businesses, including restaurants. His company has seen a "surge" of business late in 2014, and Schnitt believes it's due to chains preparing for additional health care costs.

Rising valuations, shifting M&A

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Rising sales and easing commodities have helped restaurant stocks heading into 2015, and a number of analysts are bullish heading into the new year.

Janney Capital's Kalinowski, for one, says he has Buy recommendations on most of the 16 restaurant chains he covers. "That pretty much speaks for itself," he said.

"It's not like everything is rosy," he added. "But on some important fronts, it's better."

The higher valuations should continue a shift in the mergers-and-acquisition market that started last year, as more restaurant companies are going public rather than selling to private equity groups.

Public investors are paying high valuations for restaurant brands, KeyBanc's Swanson said, especially smaller, growth chains — and that's attracting more companies to the equity markets. He believes as many as six or eight restaurant brands could go public in the next 12-18 months.

Swanson also expects fewer leveraged buyouts of publicly traded restaurant companies. Many are valued at well past 10 times to earnings — generally the limit that private equity groups are willing to pay. And federal regulators are pressuring banks to limit lending on those deals to 6 times to earnings. That gap is tough to fill, Swanson said.

"That puts a little more pressure on private equity to pick and choose buyouts," Swanson said.

None of this is to say there won't be deals in 2015. Debt is still cheap and readily available, and multiples are high, which could bring sellers out of the woodwork. Companies are being pressured to spin off divisions — sources say Darden Restaurants Inc., for instance, could spin off its Specialty Restaurant Group and Bob Evans Farms Inc., could sell its packaged foods division.

On the flip side, restaurant companies may continue adding brands in 2015 — Buffalo Wild Wings Inc. has shown a willingness to buy small growth concepts like PizzaRev and Rusty Taco, while DineEquity Inc. has said it is looking for a third concept to its Applebee's and IHOP chains.

Swanson expects such deals to be small, however. In other words: Don't expect another Burger King-Tim Horton deal.

"You'll see public companies that are starting to slow down give it a little juice by adding a second or third concept," Swanson said. "But they'll be more small, up-and-coming brands that could fit well in a larger, maturing company. I don't think there will be the big, mega-transaction."

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