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# Guide to a Casual Dining Turnaround

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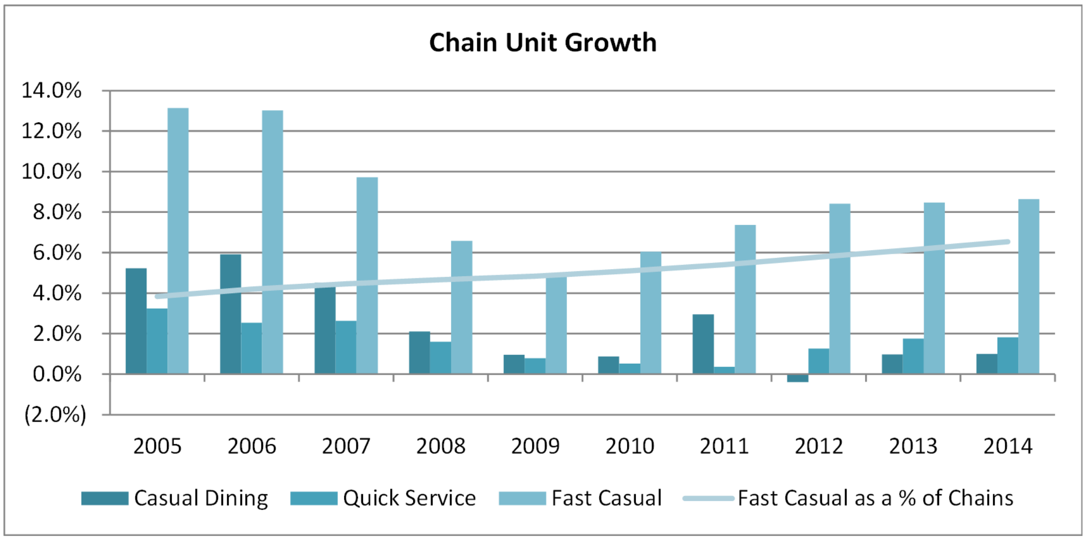
As stakeholders in Casual Dining ("CD") concepts continue to look at the turnaround potential of their investment, it is important to focus on techniques and strategies that accelerate success where others have failed.

This segment of the industry experienced steady growth in the early 2000s, with chain unit growth averaging over 5% through 2007(1). However, with an aging audience (Baby Boomers) and a shift in consumer behavior in the post-recession economy, CD chain unit growth has decelerated to an average annual rate of 1.1%(1) as it has struggled to evolve and remain relevant. With nearly 10 years of steadily declining traffic (1) and growing competition, management and shareholders are looking for answers.

The pressures facing the CD segment of the industry continue to mount, rapidly shrinking restaurant economics. Labor remains a major contributor as hourly pay grew over 3% in 2014 (after consistently growing at less than 2% for several years) due to state mandated increases and is accelerating further in 2015. As increasing costs weigh down operations, the growth of new segments within the industry are also putting additional pressure on margins, as sales decline. Among chain restaurants, the increase in Fast Casual units has long outpaced the CD segment, and in the last three years Quick Serve growth has also surpassed CD (as illustrated in the graph below).




*Source: Wall Street Research*

Management teams guiding these CD restaurant chains need to take decisive steps to evolve their brand and aggressively plan for growing costs. Absent deliberate change, some CD concepts could fall to the barrage of headwinds in the form of increasing minimum wage, growing food cost, shift in consumer trends and ever increasing competition. Traditional CD concepts will struggle to compete in this environment.

Since 2006 the cumulative decline in CD traffic is a staggering 22%(1). Time is of the essence for CD concepts as EBITDA margins tighten and the popularity of competing segments (Quick Serve and Fast Casual) continues to grow. CD companies need to shift to an offensive mindset to counter the loss of market share by strategically identifying and implementing specific turnaround initiatives to position themselves for growth and sustainability. These initiatives should include steps to both evolve the brand and to return to key attributes that once made them the preferred choice.

# Key Turnaround Steps to Fix Your Brand

A number of CD concepts struggling with difficult turnarounds turn to CAPEX investments and new menu designs to recapture consumers and drive top line growth. These initiatives only add sustainable Same Store Sales ("SSS") growth if companies are able to effectively address core issues facing the brand. Before sponsors invest considerable capital in challenged concepts, it is essential to study the customer, understand changes in customer expectations and focus on the core issues facing the segment – brand relevance, service and stretched management.

Through these turnaround efforts sponsors have to be ready for a controlled yet tumultuous ride that will help concepts break away from ineffective and outdated strategies and steer them toward relevancy, market share growth and sustainability.

## Brand Relevance

CD concepts were built to serve the Baby Boomer generation and in many instances have not evolved with changing consumer trends and preferences. With Millennials as a group now being more likely to eat at a restaurant than older generations (53% of Millennials report eating out at least once a week compared to 43% for the broader population(1)), they are usurping Baby Boomers as the top restaurant spenders in the country. As a result, companies have to focus on capturing more of this demographic by building around key characteristics that resonate with this group.

Studies show that Millennials value expedient service, transparency, authenticity and customization(1). CD concepts need to have a thorough understanding of their consumers and brand perception, and have the right team to strategically define cost-effective initiatives to tap into those specific characteristics. In evolving the brand, companies need to be mindful of their existing consumer to make sure it does not ostracize its current core consumer. This is a fine balance and management teams need to lean on research data and experienced professionals to carefully navigate this change to avoid a costly setback.

Executive teams need to carefully monitor consumer feedback by focusing on key indicators to help guide the turnaround and to measure the success of turnaround efforts. While the ultimate measure is SSS growth, the more immediate tests to validate the turnaround efforts are consumer metrics such as the net promoter scores and consumer sentiment trends measured through various online reporting tools. These metrics provide early indicators of progress and should be used to measure effectiveness and drive adjustments to any turnaround plan.

*Source: Wall Street Research*

### So the question becomes not:

"*How can we turn around our existing offering?*"

### But rather:

"*How can we evolve this offering to appeal to a new generation of diners with an entirely new value set?*"

### Or:

"*In what ways can we add (or subtract) to create a more relevant and meaningful experience for the new, younger Millennial and Gen Z consumer?*"

### And finally:

"*Do we have the right resources to do it?*"

## Service

Service is a key differentiator between CD and Fast Casual or Quick Serve. CD concepts have an opportunity to connect with guests through best in class service and hospitality. On average a consumer visit to a CD restaurant is substantially longer than at Fast Casual or Quick Serve. CD concepts need to capitalize on this time with consumers to build a relationship that will trigger return visits and increase the concept's net promoter scores. The current approach at many CD concepts is so mechanical that the whole concept of hospitality is lost, as is the opportunity to build the business.

Front of House ("FOH") personnel at CD concepts need to be thought of as sales people. Given the SSS struggles it is important that turnaround efforts be developed to focus on in-unit culture and training to maximize FOH potential. Managers need to be given the direction and resources to cultivate an environment that gets buy-in from FOH team members so they embody the brand's commitment to hospitality, incentivize them to promote high margin items and to tactfully upsell. These efforts have to be carefully orchestrated and administered so that the company culture, message and training are cohesive and consistent at all levels of the organization. Equally important is that these efforts meet the high expectations of the Millennial and Gen Z demographic, without straying away from the concept's core consumer.

Instituting a culture change and retraining a workforce can be a time consuming and arduous effort, but is an essential step in building a sustainable brand. It involves tremendous dedication, aggressive recruiting efforts, interactive systems and capital. Companies need to customize their recruiting efforts to find talent that fits the concept's strategic direction and employ systems that effectively cascade training efforts throughout the organization, measure and grade unit level employees and institute programs to retain star employees. Retaining employees is a critical piece that is often overlooked and can provide much needed consistency and stability for concepts that are in a turnaround phase.

It is important that companies provide themselves with sufficient runway by developing additional revenue generators and targeted initiatives to sustain EBITDA and sales, while the longer term turnaround initiative is fully realized. Some of the most effective and immediate initiatives that companies can evaluate are online ordering, loyalty programs, banquet and catering services, licensing, and developing dedicated local store marketing programs to better equip restaurant managers. Industry benchmarks show that online ordering, banquets and catering services can increase revenues approximately 10%(1).

Successfully implementing a cultural change toward hospitality and dedication to service requires a combined effort between HR (recruit and retain), Training (train and retrain), Operations (execute and evaluate), Marketing (internal and external messaging), IT (systems to measure) and executive management. Oftentimes companies don't have the internal resources with the expertise or the bandwidth to orchestrate such an undertaking, but it is critical to have a leader driving the process for it to succeed.

## Management Constraints

Executive teams in a turnaround situation are not equipped to singlehandedly deal with the various top line and cost headwinds facing the segment. Fighting a decline in market share, growing costs, the perception of legacy brands, changing consumer behaviors, etc. can be a monumental undertaking. Requiring executive teams to run the day to day business and to define strategies and cross-departmental plans to evolve the concept can end in failure. Executive teams are a critical component in defining the future of a concept but they need dedicated and experienced resources to help drive the process so they can focus on daily execution and operations.

Due to the demand placed on management, turnaround situations typically see a considerably higher amount of turnover at the management level compared to performing companies. This has a domino effect on operations, service, sales and profitability. The onus is on sponsors and company leaders to set their executive teams up for success by surrounding them with the resources to help turnaround the business.

Equally important is ensuring that a company has the right team in place and that they are creatively incentivized to effectively and expeditiously execute the turnaround plan. Depending on the extent of the turnaround effort, typical bonus structures may not always yield the best results.

In any turnaround effort, visibility into the operations is critical. Chief Restructuring Officers, advisors, sponsors and the executive teams need to be able to effectively measure and assess every aspect of the business to be able to react quickly and measure progress. Developing the right processes, systems and tools to do this is the first step to any turnaround. Being able to create a one-stop medium that houses all the information and metrics relative to a restaurant helps identify stars and laggards and allows management to address weaknesses immediately.

(1) *Source: Wall Street Research.*

## Summary

Casual Dining concepts need to evolve to better serve lapsed consumers and to attract an ever-changing consumer set. With growing competition and new entrants, these concepts need to act swiftly to stabilize, regain market share and build EBITDA. Supporting management with the right resources and executing on the core turnaround initiatives will stem the bleeding and more importantly, drive enterprise value through a robust and sustainable platform.

## About Mackinac Partners:

Mackinac Partners is a prominent restructuring and turnaround firm with offices in Austin, Dallas, Michigan and LA. Mackinac Partners has tremendous experience in successfully turning around and restructuring complex situations in a variety of industries and provides clients with robust financial and operational expertise to help distressed companies create value. The firm's restaurant expertise spans multiple segments of the industry (franchise to casual dining) and is headed up by Managing Director, Nishant Machado. Nishant Machado has served in multiple c-level positions across industries, including Chief Restructuring Officer, CEO, CFO and COO. Nishant Machado was recently awarded the M&A Advisor 40 under 40 award for his body of work. Nishant Machado is Certified Insolvency and Restructuring Advisor.

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