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Menu Price Increases Inevitable, Imminent for Casual Dining

Companies: AFCE, CAKE, CMG, DIN, DRI, EAT, JACK, MCD, PFCB, PNRA, RRGB, RT, YUM

March 3, 2011

Research Question:

What effect will rising food prices have on casual dining restaurants, and when will these restaurants pass the increases on to customers?

Summary of Findings

- Higher menu prices in casual dining restaurants are inevitable and imminent. Although customers have not yet seen a price increase, consultants, franchise owners and suppliers said menu prices will increase within the next month or two and will continue to go up by winter, totaling a 5% increase for 2011 overall.
- To lessen the blow to their customers, restaurant chains will first reduce portions and eliminate garnishes and side dishes and raise prices on drinks, appetizers and desserts instead of on entrees.
- Still, chain restaurants are bound to lose profits in 2011 because of higher fuel and commodity costs. Produce prices have risen in particular because of severe weather. Also, restaurants cannot pass price increases on to customers without experiencing a backlash. A restaurant manager said chains are equally concerned about customers having less disposable income in light of higher fuel and food costs.
- Larger chains with strong buying power and a loyal customer base, such as Brinker International Inc.'s (EAT) Chili's Darden Restaurants, Inc.'s (DRI) Olive Garden and The Cheesecake Factory Inc. (CAKE), are best positioned to withstand increasing food and menu prices. Fast-casual restaurants such as Panera Bread Co. (PRNA) and Chipotle Mexican Grill Inc. (CMG) and fast-food chains like McDonald's Corp. (MCD) may benefit from customers trading down in their dining choices.
- Steak houses and hamburger and seafood restaurants are likely to struggle the most with the higher commodity costs.

	Food Prices on the Rise	Price Hikes Passed on to Patrons Now	Price Hikes Soon to Be Passed Along
Industry Experts	↑	↓	↑
Food Suppliers	↑	↓	↑
Franchise Owners	↑	↓	↑
Casual Dining Managers	↑	↓	↑
Casual Dining Customers	N/A	↓	N/A

Silo Summaries

1) INDUSTRY EXPERTS

Five sources said customers are about to see menu prices rise as restaurants can no longer afford to spare their patrons. Even in doing so, **restaurants likely will see a drop in profits, as much as 10% according to one restaurant consultant.** Restaurants will do what they can to avoid raising prices by eliminating sides and garnishes, reducing portion sizes and developing new menu items with less-expensive ingredients. Prices on drinks, appetizers and desserts are likely to increase before those for staple entrees.

2) FOOD SUPPLIER

Four sources said commodity prices have increased significantly, even doubling for produce. **Customers soon will be paying 1% to 2% more on their restaurant bills, with the potential of a 5% total increase in 2011.** To limit how much is passed along to customers, restaurant chains may reduce portions and trim other operational expenses.

3) FRANCHISE OWNERS

Three sources said they have not yet raised prices and will explore all avenues before doing so. However, they acknowledged that commodity prices have increased and believe higher menu prices are inevitable. They believe independent and smaller chain restaurants will struggle the most because they lack larger chains' buying power and long-term contracts. Two sources said McDonald's was in the best position because of it size and position to catch customers as they trade down in dining. One franchise owner was more concerned about customers having less disposable income to spend in his restaurant because of higher fuel prices.

4) CASUAL DINING MANAGERS

Four of five sources reported no increase in their restaurants' menu prices despite higher food costs, but one believes higher menu prices are inevitable. The one source who reported higher menu prices said the increase was minimal and had gone unnoticed by customers.

5) CUSTOMERS

Three sources had not noticed any significant menu price increases for the larger chain restaurants. If prices have gone up, they have not affected sources' eating habits. One source reported substantial price hikes at local, independent restaurants.

Casual Dining Restaurants

Background

In Blueshift's recent reports on Wendy's Arby's Group Inc. (WEN) and McDonald's, food suppliers said food prices had been on the rise and were expected to be passed on to customers. Sources also said restaurants might counter higher food costs with reduced portion sizes.

CURRENT RESEARCH

In this next study, Blueshift assessed what casual dining restaurants are doing about rising food prices and which establishments will emerge as winners and losers in the sector as a result.

Blueshift employed its pattern mining approach to establish and interview sources in six independent silos:

1) Restaurant industry experts (5)
2) Food suppliers (4)
3) Franchise owners (3)
4) Casual dining managers (5)
5) Casual dining customers (3)
6) Secondary sources (7)

Blueshift interviewed 20 primary sources, including five repeat sources among suppliers and experts, and included seven of the most relevant secondary sources focused on casual-dining and fast-food companies raising menu prices and the expected continuation of high commodity prices throughout the year.

Silos

1) RESTAURANT INDUSTRY EXPERTS

Five sources said customers are about to see menu prices rise as restaurants can no longer afford to spare their patrons. Even in doing so, restaurants likely will see a drop in profits, as much as 10% according to one restaurant consultant. Restaurants will do what they can to avoid raising prices by eliminating sides and garnishes, reducing portion sizes and developing new menu items with less-expensive ingredients. Prices on drinks, appetizers and desserts are likely to increase before those for staple entrees. Although all casual-dining restaurants are expected to struggle because of higher food prices, The Cheesecake Factory and Darden's chains will survive because of their size and customer loyalty. Also, any restaurant that purchases locally will have an advantage given the continuing increases in fuel prices and transportation costs.

- Howard Cannon, CEO of Restaurant Consultants of America
  This repeat source said restaurants already have seen commodity price increases and that menu prices will jump next. The overall check price will increase 1.5% to 2% by summer and then jump another 1.5% to 2% before the end of 2011. Casual-dining chain sales will increase as more people dine out, but restaurants' bottom line may decrease as much as 10%. Restaurants will adjust by reducing portion sizes and hiking prices on drinks, appetizers and desserts. This source does not expect a noticeable change in entree prices and predicted fewer coupon offers. Large casual-dining chains may suffer for a while, but big players like Darden eventually will thrive.
  - "Prices are going up. Anytime there is an increase in the price of fuel, you end up with an increase in prices. We are seeing an increase in the price of all commodities and all proteins, and we will see a cost increase in the distribution channels. Restaurants either can increase their prices, reduce discounts or cost-expense something else. Otherwise, they will lose profitability."
  - "The cost to the restaurant has already gone up, but they have not passed the cost on to consumers. We will see them pass it on by summer. Restaurants tend to be conservative and use multiple paths to cut costs. Across the industry we will see a 1.5% to 2% increase on consumers' bills by summer and another price increase of 1.5% to 2% by the fall of 2011 or winter of 2012. Overall, we will see a 3% to about a 4% price increase."

Casual Dining Restaurants

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> *Howard Cannon,*
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- "Even though sales will go up in 2011 and 2012, profitability will go down. The increase in sales will come from consumers dining out more and spending more money on check totals. But we have trained them to expect to buy at a discount. If you look at the history of food pricing, you'd like to believe it's driven by supply and demand. The manufacturer or grower has less demand because there are fewer restaurants, and they responded by increasing the cost of goods. Lots of companies had some bad years in 2008, 2009 and 2010. Resources dried up; the safety net dried up; capital dried up. Now there is nowhere to turn but to raise prices."
- "We will see a 7% to 10% drop on their bottom line even though sales are up."
- "This is not the end of the world for the restaurants, but it's all in how you do it. If you look at the big chains, they rarely mess with the entree or core item. Instead, they raise the price of soda, which does not cost the restaurant anything, but they are charging the consumer through the nose. If you want to eat out and get a bargain, don't order a beverage. You may see some [chains] decrease the size of the patty or see them shave ounces off a side, but a lot of these strategies have already been used to weather the downturn."
- "If you dial down the menu, where is the profit? It's in the soft drink. A soft drink costs half of nothing, yet today you can't even get a medium drink for less than $1.49. In casual dining, the profit is in the beverage, especially if they are serving alcohol. There's also profit in appetizers and desserts. At a place like TGI Friday's you can get chicken with a starch and a vegetable for $7.99, and that won't change much because that's not where the profit is."
- "The cost of produce is the highest item because it is so volatile. It's such a perishable; plus, it's got to be distributed across the country. It takes almost nothing to upset the pricing."
- "Worse off will be the giant restaurants with a footprint of several thousand square feet of real estate. You see some of them now empty Monday through Friday, but they live and die on filling up on Saturday and Sunday. The Cheesecake Factory and P.F. Chang['s China Bistro/PFCB] and [Ruth's Hospitality Group Inc.'s/RUTH] Ruth's Chris [Steak House] may struggle for a while. But a place like Cheesecake Factory has such high volume and such a large menu and customer loyalty that overall they will be OK."
- "I think Darden will be OK. They have stood the test of time, and they are in an industry sector that does well with customer loyalty."
- "A lot of restaurants will fail. A lot will try to rebrand, and they will stay ahead of the game if they remain cognizant of costs. We may see some restaurant acquisitions, with companies selling certain brands."
- "Restaurant chains worry about and focus more on menu pricing than the customer does. In every customer survey we have ever done, we rarely hear customer say the prices at restaurant XYZ are too high. The customer does not think nearly as much about pricing as the restaurant does. If anything, I tell the restaurants their prices are too low and they could move up the price by 30¢ to 40¢ on any item and be profitable. They are too self-conscious on price, and I think it's because there has been such a strong response to coupons. But there are two types of customer: the coupon shoppers and those who don't care about price. I think there are a huge number of customers out there who fall into the second category."
- "Even with fast food, the difference between $7.50 and $7.75 or $7.85 is not a big deal. The customers don't care. But they continue to cut prices and can't make the appropriate plate price when it goes out the door."
- "I always tell my clients, 'Stop giving coupons.' Give value to drive your business. We will see … in 2011 and 2012 that the use of coupons will

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fade away unless they are delivered by outside sources like Groupon [Inc.]. Groupon can act as a marketing device for the restaurants by driving customers, and the restaurant can still see a benefit.

- **University professor/author, foodservice management expert, East Coast business school**
  This repeat source said chains have been struggling with commodity price increases for months and now must pass costs on to consumers. If entree or branded menu-item prices increase, the jump would be under $1. Complimentary sides will disappear, and portions will shrink. The source said to expect new menu items designed to disguise chains' higher costs.
  - "When the national press reports there are shortages of produce and you walk in Wendy's and see an extra cost for tomatoes, people know commodity prices are going up. Flour and corn have gone up. When flour goes up, so does the price of pizza, bread and rolls. Corn impacts feed and fuel. But if ever there was a time for restaurants to raise prices and have some empathy from customers, it's now."
  - "When you have cost inflation, consumer price inflation follows. The costs go up on the mercantile exchange, but it takes two to three, maybe four to six months before you see it on your menu. You will see increases starting now on menu items, but they won't be astronomical. And you'll see maybe 2¢ or so added to the cost of a loaf of bread at market."
  - "The chains typically work out agreements with suppliers on a cost-plus basis, so they can take the incremental increases. It's the spot market where you suddenly need produce when you have to call and say what's the price of lettuce today, where you may get hurt by high prices. But I still think many restaurants can't noticeably raise the price of items on the menu. You can raise a sandwich from $7.20 to $7.50 without notice. But it's not just a matter of passing costs on to the consumer. You need a price threshold on your entrée of $9.95. You have to create items that can sell at that price point and still make a profit."
  - "There are a lot of ways to revamp menu prices. You can create new menu items for the restaurant and charge whatever you want because it's new. There will be some developments in new menu items. You can reduce the portion size. With hamburger you can knock off a half-ounce or an ounce. You can cut out the coleslaw, eliminate the bread or get rid of the complimentary baked potato."
  - "You can make adjustments to your menu and offerings in lieu of across-the-board cost increases. But whatever happens, the menu costs will increase. They just have to. If you can go up less than $1 on an entrée or item, you can probably pass on the cost. But if you need to raise prices more than $1, you will have to create ways of disguising it."
  - "Most of the large casual-dining chains will be able to handle the cost increases because they have extensive menus and can manipulate prices in different ways. It will be tougher for fast food to manipulate because they have fewer menu items."
  - "I don't think we will see people upgrade to casual dining. It usually flows the other way, and casual dining always worries that customers will defect if prices are too high. The very high end can still offer entrees with high-end pricing. You can still have a steak and pass along the price because at the high-end people expect that you have to charge. The rub is to find a way to disguise certain costs."

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Foodservice Mgmt Professor

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Foodservice Mgmt Professor

- **Restaurant industry consultant**
  This repeat source said food prices are expected to rise more than 50%, pressuring restaurant chains to raise prices, compromise margins, or both. Some restaurant chains could weather the storm through long-term buying contracts, but steak houses, seafood chains, and burger operations will be the hardest hit. Inevitably, prices will rise across the board, and consumers will compensate by sharing entrees, ordering a la carte, or not ordering beverages.

- "Food prices are being pushed higher by many factors: slightly improving economy; significant commodity price increases; fuel costs increasing; strong export market for beef and pork; corn, soy oil, and wheat all forecast up more than 50%."
- "Grain prices will probably be the highest percentage of cost increases, which is also an input to beef and chicken but not so much with dairy. Beef will increase more than chicken. Dairy will increase significantly."
- "Nobody knows when these price increases will peak as there are too many variables between faster-recovering Asian economies buying U.S. food products, the unstable political situation in the Middle East linked to fuel costs, and job and economic growth rates in the U.S. and weather can affect supplies of grains and meat both ways. Some prices may have peaked, and others may not peak until midyear or later."
- "Restaurants will be faced with raising prices or compromising margins or some of both."
- "To defray costs, restaurants can adjust portions, move to chicken and less expensive protein. … But restaurants cannot affect markets short of McDonald's cutting their portions or deleting items. Operators need to implement stringent cost controls."
- "Menu costs increasing depends on restaurants' focus and how they react to combat higher prices. Steak houses will get hit hard, as will burger operations. Chicken prices will rise, but will be less affected and can recover supply faster. Seafood has also increased significantly, so there will be no complete escape."
- "The consumer will be impacted both at the food-service level and retail level. Some restaurant chains and retail will have more staying power depending on long-term contracts, but ultimately, sometime in 2011 prices will have to go up and consumers will feel the pain."
- "Customers will probably not bear the total cost [increases], but they will not escape."
- "Consumers will do their own 'food cost management' by ordering a la carte, eliminating beverages, ordering lower-cost or promotional items and splitting entrees."

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Restaurant Industry Consultant

➤ **Vice president of RestaurantOwner.com**

This source said restaurant owners are seeing gradual increases in food costs, specifically for produce, meat and seafood, and consumers will have to take part in paying for the higher costs. He expects menu costs to increase between 10% and 20%, with food and fuel prices peaking midsummer. Consumers are eating out less, particularly at casual and fine-dining restaurants. Restaurants that hope to succeed will likely introduce special menu items and offer smaller portions and fixed menus.

- "Our user base is primarily independent restaurant owners. Recent discussion on our member forum has indicated that operators are beginning to see gradual rises in food prices, specifically for meat, seafood and produce."
- "Restaurant operators are expecting to see higher prices and fuel surcharges much like they did in 2008 when the price of oil was so high. The impact is substantial because operators struggle with indecision on whether or not to pass those increases to their customers by raising menu prices."
- "As in 2008 when consumers' disposable income dwindled, so did their dining frequency to casual and fine-dining restaurants."
- "I expect food and fuel prices to peak in midsummer."
- "I expect increases between 10% and 20% for menu costs."
- "I expect beef and grain will see the most increase, but there will be an increase across all commodities."
- "Restaurant operators that want to defray these price increases need to plan for them now. As in 2008, many operators are expected to introduce specials, smaller portion sizes and prix fixe menus in order to create better price-value perception to their guests."
- "Both restaurant operators and consumers will pay the price. Unfortunately for restaurant operators, those that react after prolonged price increases will see their profits dip. Once they raise menu prices, consumers will carry some of the burden; however, restaurant operators will risk a drop in frequency."

> There will be an adjustment, and restaurants will lose customers. However, operators that have the foresight to anticipate these increases and make adjustments will fare better than those that can't.

VP, RestaurantOwner.com

- "There will be an adjustment, and restaurants will lose customers. However, operators that have the foresight to anticipate these increases and make adjustments will fare better than those that can't. Additionally, restaurants that have good operational, marketing and financial management systems in place stand to gain customer share and even increase volume as restaurants that struggle will begin to close their doors."
- "The restaurants in the best position to weather the adjustment period will be limited service and low-end check average restaurants."

➤ Manager of a restaurant consulting firm

This source said restaurant patrons have not yet been affected, but rising fuel costs will push up the prices of produce and, ultimately, menu items. Instead of raising prices, restaurants will omit non-core products such as garnishes. Casual dining restaurants have been hurt by fast-casual, value-driven chains such as Chipotle and Panera. Restaurants best positioned to weather this economic storm are those that can purchase locally or regionally. The source still views this slump as short-term but said a lot depends on gas prices and instability in the Middle East.

- "Consumers are not noticing an impact in restaurants yet, [but] … as fuel prices start to go up, consumers are going to see some product interruption or will see some prices increasing."
- "Compared to last winter, we're noticing tremendous increases in two areas in particular: fresh produce items, where prices are increasing due to severe storms and crop reductions; and container items like canned items, paper goods and chemical cleaning supplies. Those things are going up with the rise of transportation and fuel costs. We're getting hammered two ways. With some products, we've seen relatively insignificant increases of 8% to 12%, and [other] items are up a third or more."
- "Produce and dairy products are getting hit harder; milk, cheese and butter are up along with produce like Florida citrus, avocados and lettuce."

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>
> *Manager, Restaurant Consulting Firm*

- "We're not necessarily raising prices yet, but there are some things that are being done. Some items that may not be a core product, such as garnishments, may be omitted. Restaurants are rethinking menu items where it's not a necessary item, but we're not reducing recipes. Tomatoes are still needed in the salsa and we're not changing the recipes, but we might omit tomatoes on top of the burrito."
- "Most restaurants seem to be absorbing it for the short term because we're hoping the weather-related increase is a short-term increase. We haven't seen it as dramatic as past times, when we had to pull tomatoes out of some products or where we had to take lettuce out of some sandwiches."
- "We think the winter produce hit will peak in the next four weeks, so we're hoping it won't be too high and by the time we get into mid-March we'll be done with it."
- "We hope this short-term increase is due to fewer quantities available and a poor quality level due to the bad weather. But what really will smack us and what we don't know the long-term effects of is if there is continual instability in the Middle East and fuel ends up at an all-time high through the summer. … All commodities that require long-distance transport … will be [affected] due to the fuel."
- "Whether it's a chain or independent restaurant, the ones that are best positioned to weather this current storm are the ones that are doing a lot of 'close by' purchasing so they can be flexible and avoid a lot of the higher freight costs. The more regional in their buying and flexible in their menuing, they will be probably in the best shape."
- "In late 2010, most states started a recovery and people started spending more. … Revenue started coming back, and in the short experience we've had with 2011 that's still happening. The not-so-good news is the habits have changed. Consumers might be sharing more or spending less, or taking more home."
- "People are visiting casual-dining restaurants less than a few years ago. We see a change in customers' buying habits with more value in

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> *Manager, Restaurant Consulting Firm*

ordering. If they were previously going to eat at a full restaurant, they would be eating in a category we call 'upper casual'—TGI Friday's or [Metromedia Co.'s] Bennigan's. But then customers started rating restaurants like Chipotle and Panera in value proposition and started saving money. Casual dining started shrinking."
- "Casual restaurants are doing some seasonal 'menuing' where they will do menu promotions on items that have a better profit center."
- "Casual dining may be forever redefined as a smaller core menu, which gives them greater flexibility to add special menus. Part of casual dining was the big menu."
- "Cheesecake Factory has an incredible inventory, but there are two things they do really well. The more you study that 20-page menu book, you see there's a tremendous amount of carryover of a particular product. They are very smart with how to make 150 items but out of the same things. They do good product handling. The second thing is they just have tremendous volume. Their unit numbers are some of the highest in the industry on a per-square-foot basis."

2) FOOD SUPPLIERS

Four sources said commodity prices have increased significantly, even doubling for produce. Casual dining chains buy on long-term contracts and so far have escaped having to pass higher food costs along to customers, but customers soon will be paying 1% to 2% more on their restaurant bills, with the potential of a 5% total increase in 2011. To limit how much is passed along to customers, restaurant chains may reduce portions and trim other operational expenses.

- **Salesperson, U.S. chicken producer and distributor to retail and foodservice**

This repeat source said suppliers already have seen higher food costs and that restaurants will have to increase their menu prices. He forecast 1% to 2% higher menu prices by the second quarter and a total increase of 2% to 5% for 2011 overall. In anticipation of higher commodity and feed prices, the source bought forward but said the benefit will not last. If corn and soy prices continue to rise, so too will consumer prices.

- "We buy corn and soybean, and all have gone up. There's been an increase in flour and an increase in oil. Everything is going up. Prices have to go up."
- "We have already seen a price increase on our end. Our retailers have told us they will raise prices. It will happen soon, but we have not seen numbers. My best guess is that prices will go up 2% to 5% during the year on the consumer end. If we don't see a break in the price of corn or soybeans, prices will have to go up even higher than that."
- "Corn is at $7.20 a bushel; that's almost an all-time high. Ethanol is driving the price. Right now 42% of all corn in the U.S. goes to supply ethanol. We also have got other emerging nations, and as they become more civilized they use more corn. The more corn they use, the more the price goes up, and we see less of a supply. Right now worldwide, production is under a billion bushels of corn. Usually, the total production is at 1.2 billion or 1.5 billion or 1.8 billion."
- "We dealt with it by buying forward. We expected prices to go up, so we bought in advance. Therefore, we did not take the full brunt of the price increases we see now, but that will change down the line."
- "Less supply and higher prices are happening across the protein spectrum. Our customers have not been able to squeeze us on cost although they attempted to squeeze us last year. Mostly, businesses are paying market value. That means most have to raise prices on their customers."
- "The major restaurants have already announced in the trades that they are going up. The customer will see it next quarter. My guess is they will see a 1% to 3% increase on their bill by next quarter."
- "There's no chance the customers won't pay and soon. Everyone will pay. There is no alternative but to raise prices."
- "We are terribly upset about the ethanol issue. Who is using it? You are using it every time you fill your tank. About 10% of the gas is ethanol, and it's going to go up. It's supposed to help defray the cost of gas, but it doesn't."

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> *Salesperson, U.S. Chicken Distributor*

- **Senior vice president, foodservice supplier of flour, grains and vegetables**
  This repeat source said commodity food prices are up 5% to 7% year to year on average, but suppliers have absorbed the price hike because most casual-dining chains buy under long-term contracts. However, these restaurants now are raising or are poised to raise menu prices. Menu price hikes will not exceed 2% to 3%. Chains will compensate by reducing plate portions or cutting operational costs. The source said the cost inflation would span 18 to 24 months. Additional price hikes would depend on such conditions as overseas demand and crop health.
  - "We are seeing an increase of 5% to 7% in cost inflation across all foods. Vegetables are up 20%. Potatoes are up 10%. That's the increased cost to our customers. Poultry is the least inflationary product because there is too much capacity and too much competition, so you will see more chicken on the menus. But I don't see how the restaurants will be able to raise menu prices by more than 2% to 3%."
  - "To compensate, restaurants will reduce portions size or take other costs out of the equation. Portions are too big anyway; that it won't be a noticeable loss. If you sell a 10-ounce steak you may reduce it to nine ounces, and most customers won't notice if you fill up other areas of the plate. If you shrink your protein by 10% to 20% on size, you can make up the difference. We will also see changes in what is offered on the menu. The serving staff is the least expensive cost, but you might see restaurants reduce the back of the house."
  - "A huge amount of how much restaurants pass along to consumers depends on the contracted price and timing. Meat is not contracted out too far. Chicken is contracted out a year, and they are trying to shorten that because they have been getting 'killed.' The potato industry is contracted one year at a time. Fruit and vegetable prices are in good shape until fall."
  - "Suppliers absorb the inflation costs right now. The big casual-dining chains generally negotiate contracts in the fall. But they will be looking at price on the whole menu, factoring in the protein and produce and other costs, and they will just raise the price of the whole menu by a certain value to consider all the different variables. Usually, they raise prices twice a year, normally before the holidays in September/October and then again in early spring."
  - "Price increases are happening as we speak. McDonald's has already announced an increase of 2% to 4% this year. I believe Carl's Jr. and Hardee's [both owned by CKE Restaurants Inc.] and Ruby Tuesday [Inc./RT] have also announced [price increases]."
  - "If I owned a restaurant and had been giving bread for free, I would say … either we don't have any bread or if you want bread it will cost $1."
  - "All of the casual-dining chains are in the same boat. Casual is worse off than fast food or quick service because of the type of menu they offer. They have inflated their menu prices more than anyone else."
  - "When will it peak? If you look at the commodity board and the acreage and the demand from China and India, I would say it would take two crop rotations to get balance back in the supply side. We are talking about 18 to 24 months. Corn is at about $7.20/bushel right now. We believe corn will go to $9/bushel during this period."
  - "Corn is the best basic crop to measure because it is used as basic feed for beef and chicken and other proteins. If you look at acreage, we had about 89 million acres of corn in 2010 and it's going to 91 million acres. But raw corn holdings are in the silos and they are 5% below the annual need."
  - "Ethanol is a big driver, and 35% of the corn goes to ethanol. You may hear that it is 42%, but that is where it would be if all companies met their mandate. Also driving price is overseas demand. China had a drought, and they have been stockpiling. Australia had a drought but then flooded. Argentina has been too dry. Russia flooded. Demand out of these very big markets is high, and they have the money to buy the stuff. If China will pay a given price, that's the price."
  - "Brazil and Argentina's crops look good and they grow soybeans, so that is good for us because it will bring down the price of oil. But 60% of the soybeans from each country ship to China."
  - "There just is not enough acreage in the U.S. All acreage will go up by 10 million this year. That acreage was the set aside by the government; farmers paid not to grow. Now they can make more by growing. But imagine that all of the potato varietals in the U.S. are on 1 million acres. They will increase corn by 2 million acres, and even with that they still do not have the ability to meet needs."

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Senior VP, Foodservice Supplier

- **Foodservice director, U.S. grower and shipper of potatoes, onions and fruits**
  This source said commodity/produce prices are increasing all along the supply chain and, ultimately, the restaurant consumer will pay. At the initial end of the supply chain, prices have doubled since harvest because of bad weather that hindered crop volume. Inclement weather also pinched overseas crops, adding to pricing pressures and higher demand. Menu prices are poised to increase if they have not already, but will be determined by the individual restaurant or chain.
  - "For the potato category, costs are going up. We are already paying well above the five- to 10-year price averages. The average price for a 70-count, 50-pound box of potatoes, FOB [freight on board, a transportation term that indicates price for goods including delivery costs at the seller's expense] is $10 to $11.50. The current price is $20 to $21. To the end user, the price will be much higher."
  - "Our customers are mostly distributors that deliver to the casual dining restaurants and QSRs [quick service restaurants], but I don't know who their customers are. Right now, they are paying the price we charge because the cost is the cost and there is nothing anyone can do to ease the blow."
  - "The price increase is due to a lousy crop, and the lousy crop is the result of bad weather. The price started to steadily go up last fall at harvest."
  - "We don't export our product, but exports have been affected by bad weather and high fuel prices, which means there are fewer exports and less supply and higher prices. The price of potatoes has moved steadily upward. But I have no idea when the restaurants will raise prices and how much they will raise prices. That would be up to the individual restaurants. But I will tell you if it costs us a certain amount and we have to charge a certain amount, then our customer has to charge a certain amount of money to sell at a profit."

> The average price for a 70-count, 50-pound box of potatoes. … is $10 to $11.50. The current price is $20 to $21. To the end user, the price will be much higher.
>
> *Director, Foodservice Supplier*

- **General manager, fresh produce supplier to state foodservice restaurants**
  This source said produce prices doubled after a freeze damaged crops, including lettuce, which jumped from $20 a box to $40. He believes the end user cannot escape price hikes. Everyone must pay more all along the supply chain, and shortages already have affected menu offerings. Large chains have long-term contracts with suppliers, but all have terms to adjust in the event of cost increases from growers and distributors.
  - "We are seeing higher prices for several reasons. It costs more for freight. Diesel costs $3.40 a gallon. We are seeing higher prices for the produce itself, and the No. 1 reason was the freeze in Yuma, New Mexico. You almost can't get lettuce. Two months ago lettuce cost $20 a box. Now it costs $40 a box."
  - "We were paying the same price all year until the freeze. That's when the price went up. It jumped 22% because of the weather. The day before yesterday it snowed in Tucson and they had sleet all over the ground, so the transportation/shipping costs will be affected."
  - "There was some push back from restaurants. It comes in groups. Others just go through with it. Nobody likes what's happening."
  - "We are short on product. I hear all the processors in California are allocating supply to make it through. In one of the Wendy's nearby there is a sign that says if you want a tomato you have to ask for it. And all of their sandwiches come with tomato. There's a problem with supply and with quality and pricing."
  - "It's been hard for restaurants. They already have printed menus."
  - "There's not much we can do to defray the cost. Let's say the mark up is 18% to 20% on a product. You can get 20% when the price is $20 a box, but when it gets up to $40 a box you can't get them to pay 20%."
  - "Down in New Orleans the restaurants are paying a higher price than ever before for beef and chicken, and they are complaining about it. They are complaining about the price of produce too. But there's not a grower or a wholesaler who is not paying more."
  - "A lot of guys like [DineEquity Inc.'s/DIN] Applebee's and [Darden Restaurants Inc.'s/DRI] Red Lobster have contracts with the growers, so

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>
> *General Manager*
> *Fresh Produce Supplier*

they are paying a price long term. But I'm sure there are provisions in the contract that says they can go up on produce in a situation like this. It's not dollar for dollar, but there are terms to compensate for price changes. There is probably a high and a low for the [freight cost paid by the shipper]. That's how it was handled by my last employer who contracted directly with restaurants."

3) FRANCHISE OWNERS

Three sources said they have not yet raised prices and will explore all avenues before doing so. However, they acknowledged that commodity prices have increased and believe higher menu prices are inevitable despite fears of customer backlash. They believe independent and smaller chain restaurants will struggle the most because they lack larger chains' buying power and long-term contracts. One source said Chili's was well-positioned to withstand the pricing pressure because of its size. Two sources said McDonald's was in the best position because of it size and position to catch customers as they trade down in dining. One franchise owner was more concerned about customers having less disposable income to spend in his restaurant because of higher fuel prices.

- **Franchise partner in 43 Chili's restaurants in the Midwest and Southeast**
  This source said rising food costs have hurt the restaurants' bottom line because they are unable to pass those costs on to their frugal customers. Produce prices have increased as much as threefold on items such as red bell peppers. Thus far, Chili's has been able to maintain its prices, menu offerings and portions. To offset rising costs, Chili's is offering more appetizers that are not as affected by commodity costs. It also is making adjustments to reduce waste. Still, this source said the larger concerns are the rising costs of oil and gas and higher prices at supermarkets, which may affect customers' disposable income and dining choices.
  - "Rising food costs will hurt profitability. In produce, we have seen higher costs. We buy on the spot market, and it makes it more difficult to pass on those costs. Even if we wanted to raise prices, we can't. We cannot keep up with how frequently and how much the prices are changing. And we cannot get new menus printed in time, and by the time we do, our costs might have risen again. Plus, it is really expensive to print new menus. At Chili's, the menus are not just paper. It's a whole production process."
  - "We also have had customer backlash when the menus are constantly changing prices. The rising costs on items like meat and corn hurt our business. We can't raise prices fast enough to catch up to the cost increases. We have very frugal customers, and it's very difficult to raise prices on them. It is not a good situation."
  - "We have not raised menu prices because our guests will just go to another, similar casual-dining outlet. Customers see no delineation between the concepts of the various casual dining chains. … If you are raising prices at Chili's, the customers will cross over and dine at Applebee's. If TGI Friday's [Inc.] raises their prices, customers will just go over to [Darden's] Olive Garden. Customers will dine at whatever chain keeps their costs and menus the same. We know that, so we will do everything we can to keep prices at the same level for as long as possible."
  - "We have to eventually raise prices especially with rising food prices, but we will try to offer value to customers as well. For Chili's, $1 drafts are always a good promo that brings folks in. But the values are usually on kids' meals, which is a low-cost item for chains. Lots of chains are giving discounts on their low-cost items. Again, the idea is to get them in the door with the promo then go from there. That is what we have been seeing the last two years, and it has not stopped."
  - "There has been an increase in prices across the board in casual dining. Competitors have introduced specials. … If a chain introduces a value proposition to bring the customer in, then it, in theory, will soften the blow of higher prices on their menu. The idea is that customers have options."

Even if we wanted to raise prices, we can't. We cannot keep up with how frequently and how much the prices are changing. And we cannot get new menus printed in time, and by the time we do, our costs might have risen again. … We have very frugal customers, and it's very difficult to raise prices on them. It is not a good situation.

Franchise Partner, Chili's Restaurants

- "Chains that are larger are better able to handle the rising costs … like Chili's, Applebee's, TGI Friday's and Olive Garden. The most successful casual-dining chains are ones that focus on what they do best. If it is Chili's, we focus on burger, ribs, fajitas and a great margarita. A key to success is focusing on your core. When you get into making items that are off your concept, to try to appeal to a wider range, you cannot execute properly."
- "As a franchise, we get the leverage contacts with Brinker. They negotiate contracts with food suppliers for our major items—steak, ribs, meat—so I cannot speak much on how suppliers are reacting to higher food costs. But, I do know produce is up, considerably on some items."
- "In a month's time, the price per unit of red bell peppers went from $13 to $40. The produce suppliers are passing on their increases, and we are getting to the point where we can't eat these costs. Because we buy produce on the spot market, we know the prices and fluctuations daily. We also buy it more than anything because of their shelf life. It is too early to tell on the leverage contracts. We do not have them signed yet for this year."
- "Or they just don't have the supply available. You have to go from using tomatoes to using canned tomatoes and that affects the quality of the product. We do not want to compromise our product in this manner like others have. That just adds to the bad situation. Some companies will make switches from fresh to canned, but usually for us that is a last-ditch effort. We will probably be forced to look at alternatives to offset higher food costs, but we do not want to do anything to stop our customers from coming in."
- "With meats, if the prices fluctuate we do not really care because our price for it is locked in. We do the contracts every six months, usually June/July with renewal in January/February. That is when you really feel the costs."
- "Even with rising food costs, we have been able to keep our portions the same. Instead of an increase in menu prices, we have been able to offer new menu items that are not necessarily relying on staples of commodity prices, for example, focusing on appetizers rather than burger meats."
- "We have not had to do modifiers on the menu. We have gotten complaints on that due to the costs. We tried it once, and it was unsuccessful. For example, a guest orders a $5.99 burger and they want to add guacamole, cheese, jalapeños and a side of something. Well, when they get the bill, they are surprised to see their $6 burger is now a $10 burger. … We are not able to nickel-and-dime folks, and we do not want to."
- "Other ways we try to offset rising food costs are controlling the amount of food waste in our kitchens, control theft, and cooking the food right the first time."
- "It is hard to say what the fallout will be from rising food prices. In the bigger picture, it is not the food prices that are the concern. The larger concern is the rising oil and gas prices along with the rising prices at the grocery store. With these costs up, a larger percentage of a person's income is going to everyday costs. How much do people have left over to take their family to Chili's? That is the larger concern. If you raise prices to combat your rising prices, it is a no-win situation. Everybody is out there fighting for the same guest to come into their restaurant."
- "I do not know when these cost rises will peak. It is hard to say. It can get a lot worse. But it can also get better."

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>
> *Franchise Partner, Chili's Restaurants*

Franchisee of a casual Asian cuisine chain

This source said food prices are increasing, especially for seafood, but his chain has not raised prices over the past three years largely because of its customers, many of whom are facing difficult economic times as well. Instead, the company tries to buy more efficiently among its suppliers. However, he said menu price increases are inevitable if food prices continue to skyrocket. Rising transportation and fuel costs throughout the summer also will affect food prices. He said Chili's still will do well since a six-month hit will not affect the chain. McDonald's and Doctor's Associates Inc.'s Subway may even see revenue increases during this period.

- "Food prices are increasing over the last three to four months since our contracts have been up. Seafood has been hard to tackle down, with close to a 100% increase. Most of the food items are around 25% to 30% higher this year."

- "We haven't seen an increase in chicken. Pork has increased about 10% this year. Beef has gone up about 25% as well."
- "We do go through quite a bit of vegetables … and it hurts when there is a freeze in California or Florida because there isn't enough to go around."
- "Higher food prices will be around for a while because of rising fuel costs, and shipping these goods will take a large amount of freight. It's almost like a domino effect. We need feed to feed the chicken, and if the farmers are not producing enough corn, the prices go up because of that."
- "I hope by late summer it'll peak out and in the fall it'll start going down."
- "We're trying to market effectively and do some grassroots marketing. We are a value company restaurant for our customers, and we don't raise prices for our main entrees. In 2008, 2009, 2010, we didn't raise prices for our main items. We kind of trended with the people who were having difficult times. We didn't want to stop them from coming in by raising prices."
- "We're growing, and I think our franchise partners are definitely interested in what we have to show them. Our model fits them really well."
- "We hate to raise prices, but I think when food costs go up tremendously, it's a no-brainer. … We're kind of taking some of the loss and trying to look at the long term rather than the short term."
- "Restaurant prices for consumers won't go up immediately, but I think it'll happen for sure."
- "I hope there will be no long-term impact on customers, but I think sales will kind of dictate that when you raise prices you've got to try to bring in more customers because some of them will try to drop off. And trying to secure new customers is harder than keeping the ones you have."
- "It is difficult for us to reduce our portion size. … We have a build-your-own bowl concept where customers go to a raw food bar."
- "Competitors are all trying to buck the trend of not raising prices."
- "I think Chili's has a $6 meal for Lent. … They have enormous buying power. I'd say Chili's is the best bet to weather this current economic crunch because they can reduce prices for six months at a time and not take an impact on it."
- "McDonald's, Subway—they weather the commodity pricing, and they won't even flinch. Their revenues may go up because of it."

> **We hate to raise prices, but I think when food costs go up tremendously, it's a no-brainer.**
>
> *Franchisee, Asian Cuisine Chain*

Owner of three franchise pizza restaurants in Texas

This source said produce prices are up 20%, and he expects an increase in dairy and flour prices as well. His franchise company is looking to get away from a national price point and to alter its marketing strategy in order to compete against TGI Friday's, Chili's and even Subway. He is concerned about rising fuel prices and a potential legislative bill that will result in a 5% boost in ethanol prices. The big losers will be the independent restaurateurs that do not have the buying power or the relationships to help weather the higher food prices. Fast-food chains, like McDonald's, are best positioned to make it through this downturn. Consumers inevitably will see rising menu prices.

- "To be a member of a multiple-unit chain does definitely give you buying power, which helps you weather the storm."
- "Our company is trying to find ways now to change its marketing strategy to get away from a national price point and put out the value message, and try to use a nutrition message also."
- "We're trying to find a way to build value, so we're looking at a couple of different offerings, even having one price and certain offering of products at lunch, and then increasing that offering in the evening like other buffet concepts do. Currently, [we offer the] same price at lunch or dinner."
- "We've been fortunate in the last couple of years to lock in long-term prices. Recently, we've undergone a … leadership change at the franchisor level and are struggling a bit with our own brand identity. The franchisor knows that we have to do something to start allowing or start building the brand image so we're not tied to a [fixed menu] price. You'll see a lot of our marketing change."
- "A lot of restaurants are looking for drink specials to make up that loss in profitability through marketing their alcohol. We can only raise drinks so much. We will hit that threshold."

- "I've been impacted just like a TGI Friday's or a Chili's. Customers who normally frequented our chain two to three times a week are now eating out once a week, and we've seen a trade down from those casual restaurants like TGI Friday's at lunch time."
- "The best positioned to weather this storm is the fast-food concept because they do things better 24 hours a day than even I do. They just run harder, they adapt quicker, they are more price-sensitive. They put in breakfasts and put in coffee shops to compete with Starbucks [Corp./SBUX]."
- "The small independents are most at risk. It doesn't make any difference what food category."
- "Casual dining can control profitability through portion control."
- "The commodities really squeeze us."
- "The customer will see price increases start inching their way up, and if you see a new menu, they've changed their price on something. And the guests will start seeing it in certain appetizers or certain entrees or it may be in the cost of the additional condiments as early as spring break."
- "Most immediately, produce prices are going up. This crazy weather has affected prices of tomatoes and the lettuce harvest. We've been lucky [so far] with cheese and flour prices."
- "We've seen a 20% increase in produce prices. We're expecting to see that happen with diary and flour prices, too. Now restaurants have just a fingernail hold on that consumer to keep them coming back. We are price-sensitive to a fault."
- "Other restaurants are really struggling with price increases. While they're still trying to get that value proposition to the consumer, they are struggling with increased commodities, and now everybody in the media is going nuts over fuel price increases. We will see $5 a gallon gas shortly after spring break, and it is one of those things that will impact commodities even more."
- "If E15 passes Congress, there will be a 5% increase in ethanol, [which] will cause twice the amount of corn to come out of the food supply."
- "We expect everything to go up—cattle that are fed by corn, any products that are made from corn [such as] corn syrup, which is the cheap sweetener that is in everything from ketchup to sodas. Every food product will be impacted with higher prices."

The customer will see price increases start inching their way up, and if you see a new menu, they've changed their price on something. And the guests will start seeing it in certain appetizers or certain entrees or it may be in the cost of the additional condiments as early as spring break.

Franchise Owner, Pizza Restaurants

4) CASUAL DINING RESTAURANT MANAGERS

Four of five sources reported no increase in their restaurants' menu prices despite higher food costs, but one believes higher menu prices are inevitable. The one source who reported higher menu prices said the increase was minimal and had gone unnoticed by customers.

➤ **Olive Garden manager in suburban Chicago**

This source said higher food prices had not been passed on yet to customers. Higher costs in one food category ultimately affects other foods, whether meat, produce or dairy. Higher menu prices would have to be creatively marketed through unique incentives. This chain currently offers no deep discounts.

- "We have kept prices in the restaurants steady, but I know food prices have risen. At some point, we will have to pass the costs on to the customers and raise some prices. I know commodities are going up, but we have been able to leverage against that so far since we are a big company."
- "We can negotiate with the vendors to hold costs and get better prices. We do our best to do this, but we cannot always control the market. If we start to slow down, which I cannot imagine, we will not have a much leveraging power to hold prices."
- "At the store level, we do not handle the actual ordering, so I don't really see our actual food costs. I cannot speak to what products have

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Manager, Olive Garden

specifically increased or how much. At the grocery store, I have noticed tomatoes have increased in price, and overall produce is more expensive. That has to be felt on some level at the corporate level. I cannot speak as to how they are handling it."

- "Small chains and independent restaurants will be most affected by rising food prices. They have no leverage."
- "I notice other chains do one of two things to combat the increase in a produce item: Either they limit it in dishes or they put it on the menu as request only. Thankfully, we have not had to do either here."
- "Everything is impacted by rising food prices—beef, chicken, produce, grain and dairy. It is the domino effect. For example, if the price of grain increases, then the price of beef will increase. It will cost more to feed the cow, so the cow is more expensive to buy. If the cost of milk increases, ice cream will continue to cost more. Someone has to pay these costs. I cannot say when it will peak, but there is no doubt food costs will continue to increase in the future."
- "When we are forced to increase menu prices, we will have to get more creative with our marketing to keep customers happy and coming to the restaurant. We will have to set ourselves apart in other ways like offering exceptional service. We will need to come up with some type of incentive to make it worth the customer's while."
- "We currently do not do any type of deep discounting. If we do, it cheapens the brand. I cannot say what the customers would think, but my gut is corporate is more concerned about cheapening our brand."

Reporter Observation: At least half of the restaurant was full during the lunch hour on a Thursday. Customers ranged in age from 20 to 75. Two hosts and at least five servers were on the floor. No discounting or price promotion was apparent.

Assistant manager at an IHOP (DineEquity) in suburban Chicago

This source had not noticed a recent increase in menu prices and does not foresee one in the near future. This location reportedly is busy all day.

- "I have noticed food prices up at the grocery store, but it has not been felt here in the restaurant. We have not had a significant price increase on our menus for a while, and I do not anticipate one any time soon."
- "We are always busy here. The restaurant is hopping all morning, all day and all night."
- "IHOP has an annual promotion that is running now until the day before Mardi Gras. We have several all-you-can-eat pancake specials in honor of National Pancake Month."

Reporter Observation: At 9:30 a.m. on a Friday, the restaurant was busy and no one was waiting for a table. By 11 a.m., the restaurant was packed and at least 15 customers were waiting for a table. Customers were of all ages and races. The restaurant was clean and the staff very friendly. Two managers, four servers and several busboys were working.

Server at Red Robin Gourmet Burgers Inc. (RRGB) in the San Francisco Bay Area

This source said prices have increased 50¢ to $1 on select menu items, including chicken, in the last month. Customers have not commented on the slightly higher prices.

- "I've noticed prices increase a little bit this month. We're charging more on things like chicken, but it's not across the board on all menu items."
- "Customers don't really notice or complain that much. If they do, they'll just order something less expensive on the menu."

Reporter Observation: At 6 p.m. on a Friday, the majority of the tables were full, namely with families. A steady stream of customers came in the door, though none had to wait more than five minutes for a table. The restaurant was adequately staffed, and had no major signage promoting deals or discounts.

> **Customers don't really notice or complain that much. If they do, they'll just order something less expensive on the menu.**
>
> *Red Robin Server, egarding price increases in February*

Ruby Tuesday manager in New York City

This source said higher food costs have not affected menu prices as the chain works hard to provide customers with low-priced options, no matter the cost of food to the restaurant. Sales for January and February were higher year to year, partly because of limited-time food offers. The manager reported having plenty of competition, with Applebee's, Olive Garden and TGIF within walking distance.

- "We're providing cheaper dishes, but that's always a company goal. We like to give customers the ability to eat for a relatively economical price."
- "January was slow, but that's normal. We're still doing better than last year."

- "We're up 8% to 10% in sales compared to this time last year. Customers have responded to some of our deals."
- "We're offering limited-time deals on Mediterranean Shrimp Pasta for $16.99. We have Chicken & Mushroom Alfredo for $14.99. But, again, that's just part of us providing good prices for customers."
- "We do coupons in newspapers and magazines; we advertise new menu changes on the company's Web site."
- "We have small menu changes every three months and larger ones every six months."

Reporter Observation: At 11:30 a.m. on a Saturday, five tables had two customers each. A Limited Time Offer poster promoting a seafood entrée was displayed on a window near the front entrance. The same offer was listed on Ruby Tuesday's Web site. Diners ranged in age and ethnicity.

- **Olive Garden manager in New York City**
  This source said food prices have risen across the board, but he declined to reveal whether the restaurant's menu prices also had increased. He did say menu items had not changed. Business has been slow so far this year, a common seasonal occurrence that he expects to end once spring arrives.
  - "Everything has increased in price as far as food items. There isn't an exception."
  - "We don't have any menu revisions that I can speak of. I don't make those decisions anyway. That comes from [corporate]."
  - "We were slow in January and we've been slow this month, but that's nothing new. Our strongest months are April to August and November through December."
  - "A high percentage of our customers are local. We do get tourists … but there are a lot of regular, local customers who come here because it's Olive Garden."

Reporter Observation: At 12:30 p.m. on a Saturday, about 20 tables were filled with 50 to 60 people. The restaurant lacked any promotional signage, even in the front.

5) CASUAL DINING RESTAURANT CUSTOMERS

Three sources had not noticed any significant menu price increases for the larger chain restaurants. If prices have gone up, they have not affected sources' eating habits. One source reported substantial price hikes at local, independent restaurants.

- **67-year-old woman having lunch at an Olive Garden in Chicago**
  This source had noticed a small increase in casual dining prices but said she and other customers have not been deterred. She dines out at least once a week at Olive Garden, Chili's or Panera and will continue to do so unless prices increase dramatically. She stops at fast-food outlets only when necessary. She would like to see more promotions offered at her favorite restaurants.
  - "I noticed prices have increased some in the restaurants, but I have not seen any less people eating out."
  - "I think rising food prices will have an effect on prices in casual dining restaurants to a certain degree. I think they will pass on some of the rising costs but not all of them. Even during hard times, people still go out to eat."
  - "The increase in prices at restaurants has not had any impact on my dining habits at all. They would have to come up a lot for my habits to change. … I think I would just cut back on other expenses like clothes before I would give up dining out weekly."
  - "I primarily eat at Chili's, Olive Garden and Panera. I think the prices have gone up a little at Chili's but not enough to make me not want to go there. I cannot say what items specifically. At Olive Garden, when I look at the menu now, I think the prices of entrees have increased. You used to be able to get several of their entrees for under $10, and now there are not any, maybe one."
  - "At Panera, I have not noticed any prices increase, but I usually always get the same thing there so I might not notice it as much."

"The increase in prices at restaurants has not had any impact on my dining habits at all. They would have to come up a lot for my habits to change.

Olive Garden Customer, Chicago-area

- "I have started ordering differently but not because of an increase in prices. It is because of dietary needs."
- "I always feel healthier after I have eaten at Panera and think they have healthy food choices."
- "I have not seen any promotions here at Olive Garden or Chili's. I wish they would have more promotions. I would probably eat out more often then. I know McDonald's has promotions all the time."
- "Olive Garden is always busy. I think they are the most popular restaurant in the country. There is another location closer to my house, and I have never been able to eat there because it is always packed on the weekends."
- "I do drive through fast-food places a couple times a month but just for convenience. … I sometimes go to [Yum Brands Inc.'s/YUM] Taco Bell, but mostly I run through McDonald's."

40-year-old woman eating at a suburban Chicago IHOP

This source was aware that food prices have risen and had noticed higher menu prices at local diners, taquerias, McDonald's and AFC Enterprises Inc.'s (AFCE) Popeyes Louisiana Kitchen and minimal increases at IHOP. This source will continue to dine out but may cut back on ordering extra items. She sees more promotions at fast-food restaurants but also has used a coupon at IHOP.

- "Prices of food have risen, so restaurants will definitely have to pass it onto their customers. I have seen increases here and there recently, but nothing to stop me from eating out. If I have to spend a few more cents, I am fine with that. If prices have an extreme increase, I guess I will have to come to IHOP less often. I am not here every week though. I currently eat here twice or three times a month."
- "I cannot remember the last time I was in an Olive Garden or Applebee's, so I cannot speak to their prices. I have noticed an increase in prices here at IHOP. IHOP's prices are reasonable. I also go to a few sit-down taquerias. Prices went up at the taquerias last fall. Tacos used to be $1.75 to $1.85, and now they are at least $2.25 each."
- "I will cut back on add-ons and extra stuff. … I like to order extra items to complement my food but won't if prices increase too much further."
- "It does seem restaurants are trying to nickel-and-dime you more than ever. I could not believe it when I was recently at McDonald's. They actually wanted to charge me 45¢ cents for extra mustard! It is not like it is a piece of cheese or extra patty. That is just ridiculous."

> I have seen increases here and there recently, but nothing to stop me from eating out. If I have to spend a few more cents, I am fine with that. If prices have an extreme increase, I guess I will have to come to IHOP less often.
>
> *IHOP Customer, Chicago-area*

- "I was really shocked when I went into a Popeyes last week. There are no more meal deals. It seems that everything has gone up at least $1 or more. They used to have a snack wrap for $1.49, and it is off their menu. They also had a chicken biscuit sandwich for $1.49, and it is also out of there. I had not been to a Popeyes for a few months. I only go there once every two to three months."
- "I notice more promotions at the fast-food restaurants, especially McDonald's with their $1 menu. Subway used to never really discount beyond the $5 foot long, and now they even have a value menu. I have even seen at [Dunkin' Brands Inc.'s] Dunkin' Donuts, you can get a 99¢ medium coffee from 1 p.m. to 10 p.m."
- "As for casual dining, I did recently use a coupon at IHOP for buy-one-get-one-free of any entrée. I pulled it out of a coupon book that was mailed to me."

25-year-old man in St. Louis

This source eats at a chain restaurant once a month and had not notice an increase in prices from his last visit. A medical school student, he is cooking more at home in an attempt to save money and eat healthier, and does not view trading down to fast-food restaurants as a viable alternative.

- "I have not noticed higher prices in the last two months. I typically assume that prices are generally cheap at an Applebee's or something, and don't really take note unless it's sort of an outrageous difference. Generally, there are all these combo deals for $9.99 or something on the commercials, and I'll end up getting that. I typically never spend more than $15 on an entree."
- "Price fluctuation rarely dictates how frequently I visit these restaurants. It is more of a convenience factor for me."
- "I have made a more conscious effort to cut back on all areas because of the economy and because I am a student."

- "If I'm going to go out to eat, it should be a nicer restaurant or a restaurant I've been wanting to try. I cook for myself much more often, and casual dining visits are reserved when I absolutely have to or it's much more convenient at the moment. I used to go maybe a dozen times a year, and that number has been cut in half."
- "I've seen a lot of the commercials, and they honestly all sound the same to me. If there is an effort to mask raising prices, I am not noticing it. Recently, I've noticed a lot of combo deals where it's sort of their version of prix fixe: get an appetizer, entree and dessert for like $9.99 or something. Or the eat-for-2 commercials. Those seem like they are targeted to encourage the diner to order more than they normally would or bring company."
- "I will say that I often get the deals/specials/promotions mixed between all those types of chain restaurants. If I do end up remembering a particular deal and want to go to that restaurant, I'll have to go online to double-check if it's for the right restaurant."

Secondary Sources

Seven secondary sources provided examples of casual dining and fast-food companies raising menu prices, their efforts to avoid raising menu prices by eliminating certain menu items, and the expected continuation of high commodity prices throughout the year.

- **Feb. 25 SunHerald.com article**
  This article stated that seafood and produce prices were on the rise in Southern Mississippi, leading to the suspension or elimination of various items from certain restaurants' menus.
  http://www.sunherald.com/2011/02/25/2895613/food-prices-on-the-rise.html
  - "Cold and rain in California, freezes in Florida and Mexico, political riots overseas all are contributing to rising food prices and food shortages in South Mississippi."
  - "It's not just affecting lettuce and tomatoes. The weather and jittery commodities markets are causing shortages and price spikes for crab legs, catfish and other foods, prompting some local restaurants to alter their buffet choices and menus."
  - "Ed Layton, vice president of food and beverage and hotel operations for Island View Casino Resort in Gulfport, said even more important than the rising price of snow crab is the scarcity of them."
  - "'Like others in the industry, we found the availability to be unreliable,' he said. 'After observing the trends in the market many months ago, we made the decision to switch to Pacific Dungeness crabs.' By making this change, he said Island View's buffet can consistently provide crab 'that is actually of better quality.'"
  - "Palace Casino responded to the shortage and price increase by temporarily pulling crab legs off its buffet.
  - "'We will still feature many seafood items, including boiled shrimp, fried shrimp, fried catfish, baked whitefish and a wider selection of seafood items on Friday and Saturday nights,' the notice on the company's website says."
  - "'We did want to preserve the price of our dinner buffet,' said Jeana Tribble, director of marketing. Instead of raising the price, they did away with the crab."
  - "Guests have been understanding, she said, and the Palace is preparing to open a new buffet in April that will have new dishes."
  - "Boomtown Casino charges $4 less for its buffets Monday through Thursday by eliminating crab legs. On Friday, Saturday and Sunday, guests pile their plates with snow crab and Dungeness crab."
  - "'We are just paying more for everything,' said Mary Cracchiolo-Spain, director of public relations for the Beau Rivage Resort and Casino. She said they are paying close to 90% more for green peppers, zucchini, cherry tomatoes, regular beefsteak tomatoes, yellow squash and

'We are just paying more for everything,' said Mary Cracchiolo-Spain, director of public relations for the Beau Rivage Resort and Casino. She said they are paying close to 90% more for green peppers, zucchini, cherry tomatoes, regular beefsteak tomatoes, yellow squash and romaine lettuce than they spent for those ingredients last year. … She said they still are buying the produce, but not passing the cost along to customers. 'Despite our cost increases, menu prices remain the same.'

SunHerald.com Article

- romaine lettuce than they spent for those ingredients last year."
- "She said they still are buying the produce, but not passing the cost along to customers. 'Despite our cost increases, menu prices remain the same.'"
- "Some of the national restaurants—Wendy's and Chili's among them—are taking tomatoes off their menu."
- "From now through Memorial Day, South Mississippi consumers should expect much higher prices for tomatoes, green peppers, cucumbers and carrots, Beau Blalock, sales manager for Adams Produce in Biloxi and a board member for the Mississippi Hospitality and Restaurant Association said."
- "Look for the prices to come down some when supply returns, he said, but if the price of diesel fuel continues to rise, that will eliminate much of the savings."
- "He said produce prices will be lower at area farmers markets, where people can buy locally grown hothouse tomatoes and squash."

➤ **Feb. 25 *Wall Street Journal* article**
This article highlighted rising food prices resulting from higher grain prices. Although supermarkets and restaurants are hesitant to raise prices, some now are giving in to the need to pass increased costs on to customers.
http://online.wsj.com/article/SB10001424052748703408604576164380442006442.html?mod=googlenews_wsj

- "The surge in grain prices that has been stoking food inflation for months in much of the world is beginning to seep into U.S. supermarkets and restaurants."
- "U.S. food prices will jump between 3% and 4% this year, the U.S. Agriculture Department forecast Thursday, after rising in 2010 by the slowest rate since 1962."
- "The cost of processing food is soaring in part because foreign demand for U.S. agricultural commodities is surging at the same time the rising price of gasoline is stimulating the biofuel industry's appetite for corn to make ethanol."
- "Prices of corn, wheat and soybeans—crops that are ubiquitous in U.S. food products—are up 88%, 76% and 37%, respectively, from 12 months ago. The soaring cost of fattening livestock with grain is also helping to lift prices of hogs and cattle to record-high levels. On top of all that, rising oil prices are lifting costs of packaging and transportation."
- "The USDA raised its 2011 food-inflation forecast Thursday from the 2% to 3% range it had been projecting since July. The government's consumer-price index for all food rose 0.8% in 2010. A change of one percentage point in the food-inflation rate is equal to about $12 billion in annual spending."
- "The USDA expects food prices this year to climb at roughly twice the general inflation rate. But U.S. consumers are insulated from the full brunt of the price spirals under way in many emerging and developing economies, where raw commodities represent a bigger share of food costs, and people spend a far bigger proportion of their incomes on food than do U.S. consumers. In India, where tens of thousands of people protested high food prices this week, food prices have been climbing at double-digit rates."
- "In the U.S., supermarket executives remain leery of hitting consumers with much higher costs for fear they will shop elsewhere. The stubbornly high unemployment rate is still casting a shadow over many consumers, who are pinching pennies despite the recession's end."
- "'Right now, it is trench warfare between food companies that want to raise prices and supermarkets, which don't,' said Michael Swanson, an economist at Wells Fargo & Co., who thinks retail food prices will climb between 4% and 4.5% this year, and perhaps higher."
- "'We're taking a lot on the chin,' said Sara Lee Corp. Chief Executive Marcel Smits at a recent conference for consumer-goods investors. His company expects to face $550 million in higher commodity costs this fiscal year compared with the prior year, as prices for coffee and other goods continue to rise."
- "Kraft Foods Inc. recently said its commodity costs in North America could climb between $700 million and $800 million in 2011 from last year."
- "Even Starbucks Corp., which lately has seen both customer visits and the average price customers pay for drinks increase, is hesitant to recover its skyrocketing coffee costs with across-the-board price increases, preferring instead to raise prices only on certain products in certain markets."

> **Texas Roadhouse Inc., a 345-unit steak chain based in Louisville, Ky., on Tuesday said it would raise menu prices by 1%, even though it expects its food costs to rise by 3% this year.**
>
> *Wall Street Journal Article*

- "'With the economy and the pressure people are under, I just don't think that's the right thing to do at this time,' said Howard Schultz, Starbucks chief executive officer, in a recent interview."
- "Texas Roadhouse Inc., a 345-unit steak chain based in Louisville, Ky., on Tuesday said it would raise menu prices by 1%, even though it expects its food costs to rise by 3% this year."
- "Some meatpackers seem to be having the most success pushing along their higher costs, in part because per capita supplies of beef and pork are shrinking, which gives them some pricing power. Retail beef prices in January were 9.7% higher than in January 2010 while retail pork prices were 9.9% higher."

Feb. 22 Tradingmarkets.com article
The article discussed Red Robin's plans to increase prices 1.5% in April because of rising food costs.
http://www.tradingmarkets.com/news/stock-alert/rrgb_red-robin-gourmet-burgers-posts-results-for-the-fiscal-fourth-quarter-and-year-end-1506304.html

- "In addition, the Company plans to take a price increase of 1.5% in April of this year to help mitigate commodity cost increases it expects to incur in 2011."

Feb. 23, Jack in the Box Inc.'s (JACK) 1Q11 earnings report
The earnings report stated that Jack in the Box's food costs were higher than last year because commodity prices have increased. Commodity prices reportedly were offset by lower costs for produce, but this advantage may end soon given our primary sources' reports of higher produce prices.
http://insurancenewsnet.com/article.aspx?id=249172

- "Overall commodity costs were approximately 2.3% higher in the quarter, driven by higher costs for beef, cheese, pork, dairy and shortening. These increases were partially offset by lower costs for poultry, bakery and produce."
- "Food and packaging costs were 80 basis points higher than prior year."

Feb. 24 JournalStar.com article
This article discussed Secretary of Agriculture Tom Vilsack's continuing push for exports despite higher food prices and lower grain stocks.
http://journalstar.com/business/agriculture/article_f328082a-de3d-53aa-aa6a-29d56be62e3d.html

- "Despite the forecasts of continuing tight stocks in major crops, high food prices and international issues, Agriculture Secretary Tom Vilsack said the U.S. 'is not going to take the foot off the gas' when it comes to pushing increased agricultural exports, DTN reported Thursday."
- "'We're not going to do that,' Vilsack said at a USDA Outlook Forum in suburban Washington. 'We're just simply not going to do that. We're going to continue to invest and promote the American brand of agricultural products around the world.'"
- "Almost everything with a price attached to it in agriculture is going up this year, including production, according to the Department of Agriculture's chief economist."
- "Corn supplies will remain tight in the United States, the world's largest grower and exporter, even after a projected increase in planting boosts production to a national record, USDA Chief Economist Joe Glauber said Thursday at the USDA forum."
- "Farmers will harvest a record 13.73 billion bushels of corn, up from 12.447 billion last year, with 5 billion bushels devoted to ethanol, compared with 4.95 billion for the 2010 crop, Glauber said. Increased demand will limit a gain in inventories, with supplies on Aug. 31, 2012, rising to 865 million bushels from 675 billion expected at the end of the current crop year, Glauber said."
- "'Despite an increase in acres, the corn market is going to remain tight,' Glauber said. 'It points to the fierce competition for acreage this spring.'"
- "Corn prices for farmers will average $5.60 a bushel in the marketing year that begins Sept. 1, compared with an estimated $5.40 this year, Glauber said. The average farm price for soybeans next season may

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>
> *JournalStar.com Article*

rise to $13 a bushel from $11.70 in the current year, and wheat may rise to a record $7.50 a bushel from $5.70, he said. The average cotton price will be a record $1.10 a pound, up from 81.5 cents this year."

- "Corn is the biggest U.S. crop, valued at a record $66.7 billion in 2010, followed by soybeans at $38.9 billion, also an all-time high, government figures show."
- "Stable production, increased exports and some recovery in domestic demand should help maintain livestock prices near last year's historic highs, Glauber said."
- "Steer prices are expected to average a record $102-$109 per hundredweight this year, compared with $95 in 2010."
- "After two years of relatively low inflation, higher prices for crops and livestock will again pressure food prices. In 2010, the Consumer Price Index for all food increased by 0.8%, the lowest annual food inflation rate since 1962, Glauber said. USDA's Economic Research Service has increased its forecast for the all-food CPI to 3-4% for 2011."
- "Tighter supplies of grains helped boost global food costs by 25% last year, reaching the highest ever last month, according to the United Nations. Rising demand also is helping to boost net-farm income in the U.S. by 20% this year to a record $94.7 billion, the USDA said earlier this month. U.S. farm exports will jump 25% to a record $135.5 billion in fiscal 2011, Glauber said Thursday."
- "U.S. soybean output will rise to 3.345 billion bushels this year from 3.329 billion in 2010, with end-of-year inventories at 160 million bushels, an increase of 20 million bushels, according to the USDA. The U.S. is the world's largest grower and exporter of the oilseed."
- "Wheat production will be 2.08 billion bushels, down from 2.208 billion in 2010, because of lower yields, Glauber said. U.S. wheat exports are forecast at 1.15 billion bushels, down almost 12% from this year's 1.3 billion bushels."
- "Overseas purchases of agricultural products from the U.S. probably will jump $26.8 billion in fiscal 2011 from the year that ended on Sept. 30, Glauber said. China is forecast to be the top market for U.S. agricultural exports at $20 billion, surpassing Canada's $18.5 billion, he said. Imports will be a record $88 billion."
- "Grain demand is rising worldwide. Saudi Arabia's cereal imports may reach a record this year, the United Nations said Feb. 3. Algeria, Morocco, Iraq, Bangladesh, Turkey and Lebanon have issued tenders to buy wheat or rice this month, as food inflation encouraged political unrest that toppled governments in Tunisia and Egypt."

Jan. 26 B2C Marketing Insider article

The article highlighted McDonald's plans to increase menu prices to offset higher commodity prices.
http://www.b2cmarketinginsider.com/trends-news/mcdonalds-announces-plan-to-increase-menu-prices-011661

- "The McDonald's Corporation has announced plans to raise the prices of many of its menu items. The fast food giant is seeking to offset its operational costs through the price increases."
- "The price increases are aimed to cover the projected cost increases, which are estimated at 2 percent for its operations in the United States and 3.5 percent to 4.5 percent for its European locations."
- "The report did not include a forecast for its Asia market. Last year, McDonald's raised prices in China to compensate for rising commodity costs. Prices in Great Britain were also raised in response to a new values-added tax that took effect on January 1."
- "McDonald's has identified ten commodities that are likely to contribute to the price increases, including wheat and meat products."
- "Many other food corporations will take a hit as prices increase. Starbucks recently reported that rising coffee prices will impact its profits more severely than they had anticipated."
- "As food prices around the world increases, it is likely that other fast food chains will also raise their menu prices. Fast food corporations will have to make their pricing decisions carefully in order to remain competitive. McDonald's Corporation's CFO noted that McDonald's will make an effort to not deter customers by limiting the price increases."

Dec. 20, 2010, *Atlanta Journal-Constitution* article

This article displayed how restaurant chains are grappling with higher prices for key ingredients that are expected to increase even further in 2011. They must decide whether to pass price hikes on to consumers or see a decrease in margins. Menu prices rose 1.7% at Applebee's, Chili's locked-in price protection expires later in 2011, and Darden Restaurants raised prices 2%, choosing a steady and consistent approach over sudden increases.
http://www.ajc.com/business/with-costs-rising-restaurants-783484.html

- "In what is—they hope—the tail end of the worst slump in decades, restaurant chains big and small are wrestling with higher prices for key ingredients and crops. The costs of corn, wheat, pork, beef and chicken have risen and are expected to jump more next year."
- "The big question: When or even whether to pass along those costs. Sure, charging more could help protect profits—but it could also startle customers already shocked by the economy."
- "Some operators say they plan to raise prices gradually if consumers give them the go-ahead. Others want to hold prices steady and see what their competitors do."
- "'What has kept the industry from suffering steeper declines is restaurant operators offering really good deals,' Bonnie Riggs, restaurant analyst at The NPD Group, said. 'They cannot pull away from that—they're going to have to wean consumers off of that gradually. If restaurant operators try to raise prices, in my view, you can't really do it right now.'"
- "Global factors are roiling the notoriously unpredictable food markets. A drought in Russia caused wheat prices to rise and more corn was used to make ethanol, pushing grain and corn prices up 40 and 60%, respectively."
- "Demand from China has raised the price of soybeans, a key part of animal feed. Coffee and sugar are at 13- and 30-year highs, respectively. Beef is up 19% this year, according to Bloomberg. Higher feed costs are also expected to push up the price of chicken."
- "Hedging strategies, with buyers locking in ingredient prices at set rates for a certain period, have helped some companies reduce their exposure to higher costs."
- "A purchasing co-op helps roughly 1,900 Applebee's restaurants in the U.S. restrain ingredient costs, said Michael Archer, president of Applebee's Services. Menu prices rose 1.7% in the third quarter, widening profit margins at company-operated Applebee's restaurants."
- "Ruby Tuesday Inc. said its commodity costs were relatively stable in the most recent quarter. A representative of Ruby Tuesday said the company makes long-range purchasing commitments and aggressively solicits multiple bids."
- "Dallas-based Brinker International Inc., which controls Chili's Grill & Bar and Maggiano's Little Italy, enjoyed better prices for meat, seafood and poultry in the quarter ending Sept. 29. In the current quarter, about 90% of Brinker's "food basket" is under contract, meaning costs don't depend on fluctuations in the open market. But much of that protection expires later in 2011. That could put pressure on steak prices."
- "Darden Restaurants Inc., the parent company of Olive Garden, Red Lobster and LongHorn Steakhouse, has raised prices about 2% this year. It's important to raise prices steadily and consistently instead of delaying them for years, said Andrew Madsen, Darden's president and chief operating officer. Sudden price increases can shock guests, he said."

Next Steps

Blueshift's next report on casual dining will focus on higher menu prices' effect on consumers. We will determine whether casual dining patrons are trading down to fast-casual and fast-food restaurants, or simply are eating out less given higher costs of fuel and groceries. We also will follow up with suppliers to gauge the duration of rising commodity prices and will ask restaurant consultants to pinpoint which casual dining brands are struggling more than others as summer arrives.

Additional research by Carolyn Marshall, Cheryl Meyer, Kyle Stack and Tina Strasser