THE VALUE WARS

GREENWICH CAPITAL GROUP

REMEMBER WHEN YOU COULD WALK INTO SUBWAY AND GET A $5 FOOTLONG? THOSE DAYS ARE LONG GONE.

What was once a budget-friendly option for feeding your family has become less affordable. Inflation hasn't just affected grocery and gas prices; it's also driven up fast-food prices. The once-strong appeal of fast food as a low-cost option has diminished, leading many consumers to avoid eating out altogether. Recent research from Finance Buzz revealed that average menu prices have surged between 39% and 100% from 2014 to 2024. With such variability in pricing, what was once a reliable, budget-friendly option now depends heavily on where you are, making it increasingly difficult for consumers to find affordable choices. As a result, the fast-food industry is facing a new reality where price-conscious diners are reconsidering their options

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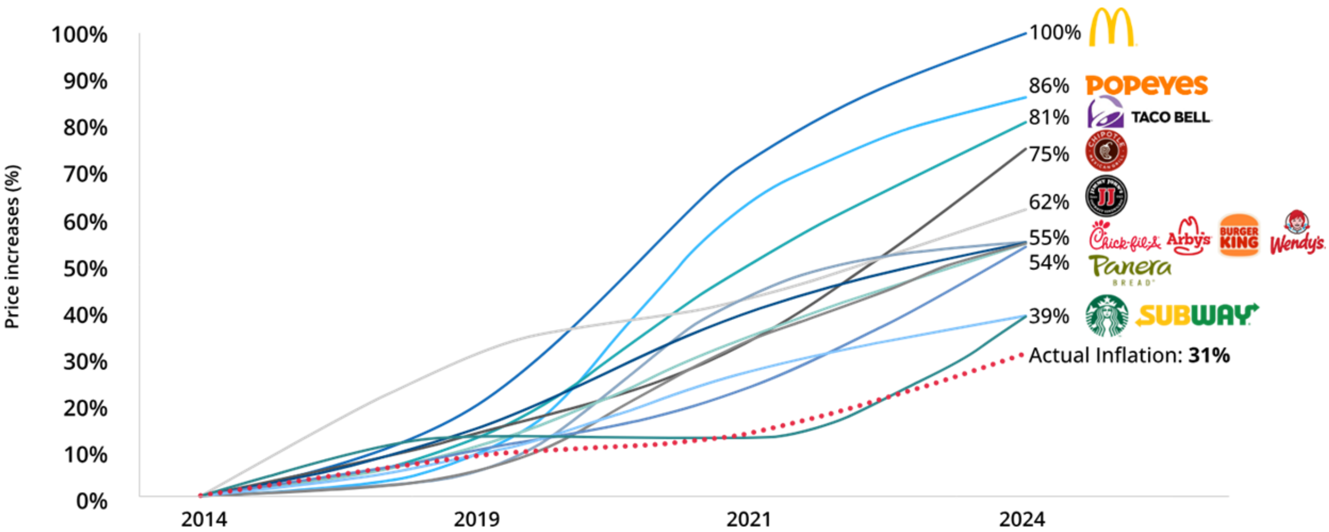
Fast Food Price Inflation

Menu prices have outpaced national inflation rates at every fast food restaurant since 2014.



Sources: *Fast Food Price Inflation.* Finance Buzz, May 30, 2024. https://financebuzz.com/fast-food-prices-vs-inflation
A Sticky Situation. Aristotle Funds, May 2024. https://www.aristotlefunds.com/post/a-sticky-situation

In response, many fast-food restaurants have been seeking ways to attract customers back. Many have introduced 'value meals,' which typically offer a combination of items at a lower price than if ordered a la carte. These value meals are often not intended to be permanent menu options, but rather promotional, limited-time deals designed to entice customers

Examples:
Value deals, such as the $1 menu at McDonald's, have been around for quite some time but have gradually disappeared as prices rose due to inflation. As fast-food chains strive to compete and gain market share, value meals have gained popularity. Recent examples of this trend include:

It's evident that customers aren't "loving it," as McDonald's has experienced the largest price increase among fast-food chains, with some menu items more than doubling over the past decade. To try and counter this, McDonald's introduced a $5 value meal, including items like a McChicken or McDouble, a 4-piece nugget, fries, and a drink, which would cost around $10 if ordered separately. Originally intended to last only a month, this value meal has been extended due to its success on bringing customers in. Franchisees were given the option to vote on whether to extend the deal at their locations, and approximately 80% chose to continue offering it until December.

Sonic has recently joined the value wars with its $1.99 “Fun.99 Menu.” Unlike its competitors, Sonic has taken a different approach by making this menu a permanent offering. Customers can choose from a quarter-pound double cheeseburger, queso wraps, chili-cheese coney dogs, small tater tots, and a small shake, all priced at $1.99 each. This contrasts with other chains' temporary value deals.

Taco Bell has recently entered the fray with one of its "biggest deals ever." Available until September, the $7 “Luxe Cravings Box” includes their most popular items: a Chalupa Supreme, a Beefy 5-Layer Burrito, a Double-Stacked Taco, and chips with nacho cheese. Similar to other deals, purchasing these items separately would cost about twice as much as the box.

Just a day before McDonald's launched their $5 meal deal, Burger King introduced their $5 Duo deals, offering customers a choice of any two items from a selection of BK Royal Crispy Wrap flavors and/or a Whopper Jr. Burger King has also decided to extend their deal past the original end date, due to its profitability.

In 1989, Wendy’s was the pioneer in introducing value meals, and today, they remain competitive in the value wars. While their $5 Biggie Bags were introduced in 2019, Wendy’s offers a unique twist by including a free Frosty with orders placed through their mobile app. They also continue to offer their popular 4 for $4 meal deal and have expanded their value offerings to include a $3 breakfast deal.

How Much Value Is in Your Value Meal?

FinanceBuzz evaluated how much consumers can save by purchasing recently introduced value meals at major fast-food chains compared to buying the same meal a la carte.

	Value meal cost	A la carte cost	Savings ($)	Savings (%)
Luxe Cravings Box	$7.00	$15.65	$8.65	55%
$5 Biggie™ Bag	$5.00	$10.75	$5.75	53%
$5 Meal Deal	$5.00	$9.96	$4.96	50%
My Hut Box™	$6.99	$12.29	$5.30	43%
$5 Your Way Meal	$5.00	$8.66	$3.66	42%
Taste of KFC 2 Pc. Deal	$4.99	$8.20	$3.21	39%
Pairings Menu	$6.00	$9.20	$3.20	35%
Shake Up Your Burger Meal	$9.99	$14.37	$4.38	30%
Big Box	$6.99	$8.50	$1.51	18%

Sources: Official restaurant websites and mobile apps

FINANCE BUZZ

Source: *How Much Value is in Your Value Meal?* Finance Buzz, Aug 14, 2024. https://financebuzz.com/fast-food-prices-vs-inflation

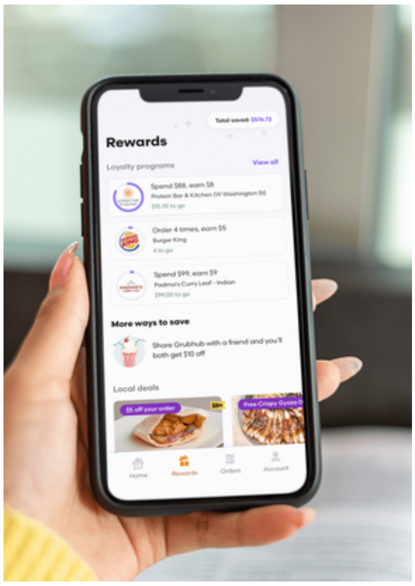
Do Value Meals Deliver True Value?

For fast food chains offering these value meals, most companies assert that they aren't "loss leaders." However, the profit margins on these deals can be slim, with the McDonald’s value meal being said to bring in only 1-5% of profit, the hope is that consumers will order additional items from the regular menu to boost overall ticket prices. Many fast-food chains have seen an uptick in customers, but earnings have varied, with some chains like McDonald's experiencing a decline in the first quarter it was introduced, while others like Taco Bell have seen increases.

However, this might not bring value to a chain restaurant in terms of customer loyalty. While value meals are effective in attracting budget-conscious consumers, they often fail to foster long-term loyalty to a specific brand or restaurant. These deals tend to appeal primarily to price-sensitive customers who are more likely to chase the best bargain rather than remain loyal to one place. As a result, when a competitor offers a more attractive deal, these consumers can quickly switch, making it challenging for any one chain to build a lasting connection. Without elements such as unique offerings, exceptional customer experience, or a strong brand identity, value meals alone rarely cultivate deep customer loyalty. Additionally, research has demonstrated that satisfaction, trust, and commitment—each building on the other—are essential steps in cultivating customer loyalty. High levels of satisfaction increase the likelihood of developing trust, which in turn fosters commitment, ultimately leading to long-term customer loyalty.[1]

For consumers, meat eaters are likely to benefit the most. Beef prices have risen 4.5% compared to last June, and overall meat prices are up 3.5%. The value of these deals largely depends on the offerings and ingredients used by each restaurant.

Some consumers believe that fast food price increases are a tactic to encourage customers to download their apps, which offer more deals and promotions than other ordering methods, including rewards for frequent purchases. For example, Wendy's mobile app provides 10 points for every $1 spent, along with app-exclusive deals like BOGO offers, coupons, and free items. To add, Subway launched a $6.99 footlong deal, available only through online orders, which lasted about two weeks as part of the ongoing value meal competition.While it's not as appealing as the classic $5 footlong, it was still a significant discount depending on the sub and location. These app-based promotions might be perceived as customers paying extra for the "privilege of assistance" if they opt not to use the app.



Further, consumer perception of value can extend beyond mere cost savings, with some individuals considering factors like convenience and portion size. Some consumers have been drawn to chain restaurants like Chili's and Applebees, who are also trying to compete with fast food value meals. Chili's is offering a $10.99 3-for-Me deal that includes a starter, entrée, and drink. Many consumers perceive these as a better deal than the fast food value meals, due to the quality of the items offered. Applebees' is offering a 2 For $2X – where customers can get two entrees, an appetizer, and two side salads for the price of $25.00.

[1]Sahagun, M.A., & Vasquez-Parraga, A.Z. (2014). "Can fast-food consumers be loyal customers, if so how? Theory, method and findings." Journal of Retailing and Consumer Services, 21 (2), 168–174. https://doi.org/10.1016/j.jretconser.2013.12.002

Future Predictions

As prices continue to rise, consumers are increasingly drawn to deals and low-cost options. It's likely that the battle over value will remain a prominent trend, with more fast-food and restaurant chains jumping into the action. As long as these chains see a boost in customer traffic without sacrificing profits, they will continue to offer value meals.

On the flip side, if grocery prices start to decline, we could see a shift in consumer behavior, potentially reducing the demand for value meals. As groceries become more affordable, consumers might opt to cook at home more frequently, finding it cheaper and healthier than dining out. This could pressure fast-food and restaurant chains to either innovate their value offerings or face a potential decline in sales. While the value meal wars are intense now, a downturn in grocery prices could challenge their long-term viability.

How can this affect M&A?

Valued at nearly $700 billion in 2022, the fast food market is projected to grow to approximately $1.2 trillion by 2032, with a CAGR of 5%.[2] This growth is fueled by the increasing demand for convenient, ready-to-eat meals. However, the dynamics of the "value meal wars" can significantly impact mergers and acquisitions within the sector.

Profit Margins

The competitive pricing of value meals typically results in lower profit margins, potentially affecting a target company's overall financial health. When a company relies heavily on value meal promotions, it may face challenges in maintaining profitability. Buyers will need to carefully assess whether the target company’s value meal strategy can be optimized post-acquisition to improve margins. This could involve renegotiating supplier contracts, adjusting menu offerings, or leveraging technology to drive operational efficiency.

Market Position

Smaller fast food chains that struggle to adapt to rising costs and the intense value wars might become attractive acquisition targets for larger companies. This potential consolidation could reshape the competitive landscape, creating a market where dominant players control a larger share. In this environment, larger chains may pursue acquisitions to expand their reach, streamline operations, and achieve economies of scale, ultimately driving M&A activity.

Consumer Behavior

If grocery prices decline, consumers might opt for home cooking over dining out, which could dampen the demand for value meals. This shift in consumer behavior could pressure fast-food

[2]Data Horizon Research (2023). “Fast Food Market To Reach USD 1,141.8 Billion By 2032 CAGR: 5.1%.“ Yahoo Finance. https://finance.yahoo.com/news/fast-food-market-reach-usd-001000772.html

chains to innovate or risk declining sales. Buyers will need to consider these market dynamics when evaluating acquisition opportunities, especially as companies may need to diversify their offerings or pivot strategies to maintain relevance

GCG Insights and Conclusion

As we look ahead, the ongoing battle for value will continue influencing the fast-food and restaurant industry, directly affecting M&A activities. The competitive environment and evolving consumer behavior present both opportunities and risks for strategic buyers and investors.

1. **Strategic Positioning**
   Larger franchisees or independents will likely leverage M&A to consolidate their market position, acquiring smaller chains that struggle to compete in the value-focused landscape. For buyers, targeting chains that have successfully adapted to value meal strategies—or have room for strategic optimization—could present attractive investment opportunities. Post-acquisition, buyers can employ their scale, operational expertise, and technology to enhance the profitability of these acquired assets.
2. **Valuation Considerations**
   The prominence of value meals means potential buyers need to scrutinize a target's revenue streams, especially how much relies on promotional pricing. Lower profit margins associated with value meals may impact valuations, requiring a more detailed analysis of how these offerings fit within a target's overall strategy. For chains successfully drawing in customers with these deals, the focus will be on converting this traffic into higher-margin sales, which could positively influence valuations.
3. **Innovation and Adaptability**
   Chains that show agility in adjusting their value offerings in response to market changes will likely be seen as more attractive targets. The rise of app-based promotions, for example, illustrates how technology can drive consumer engagement and loyalty, enhancing long-term revenue potential. Buyers should look for companies with the infrastructure and customer base to leverage digital channels effectively.
4. **Market Resilience**
   With the potential for fluctuating consumer preferences between eating out and cooking at home, diversifying within the restaurant and fast-food sector becomes crucial. Strategic buyers may explore acquiring brands across different segments, including casual dining and meal kit services, to hedge against market shifts.

In summary, the value wars are reshaping the fast-food industry and, in turn, affecting how companies approach growth and acquisition strategies. We anticipate increased consolidation in the market, with larger players seeking to acquire adaptable, innovative chains that align with their strategic vision. For buyers and sellers alike, understanding the balance between offering value to consumers and maintaining healthy margins will be key to driving successful M&A outcomes in this evolving market.

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axium FOODS, INC
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SNACK CK FOODS
a portfolio company of
NEXUS CAPITAL

GREAT LAKES POTATO CHIP CO
has been acquired by
LaSalle Capital

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