Daily Livestock Report

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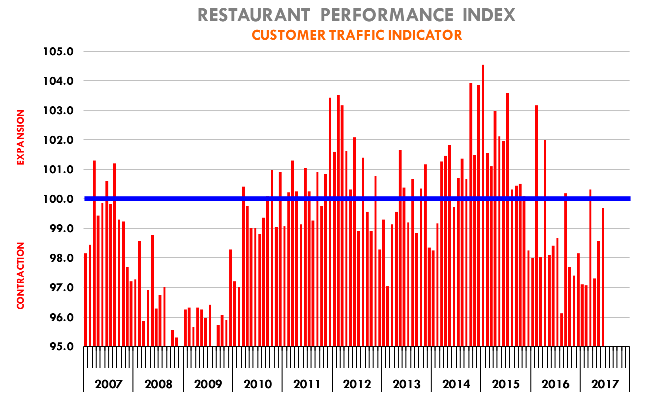
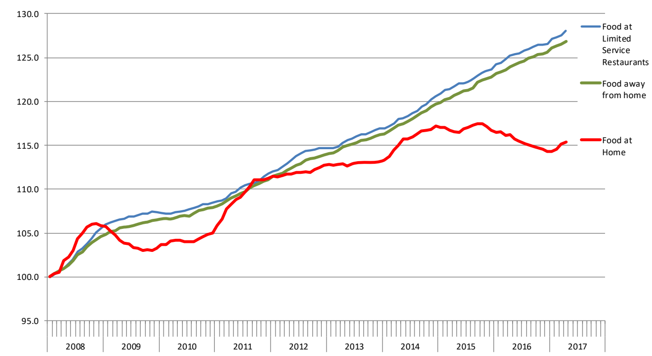
The topic of foodservice demand is one that comes up often, and with the summer retail grilling demand behind us, **<u>we think it will be an important consideration for the market going forward</u>**. The Restaurant Performance Index is one of those indicators that some, including us, have referenced in the past as a gauge of trends in the foodservice business. While still useful, we also think it is important to **<u>consider some caveat</u>**. The index is constructed so that it measures whether the industry is growing or contracting. Several index components offer insights about capital expenditures, same-store sales and traffic counts. The latter point is particularly important in our view. It is difficult to expand the business, and especially the volume of protein sold (of interest to this audience) without increasing the number of customers walking through the door. Frequency of visits is a critical concern, with some restaurants indicating their customers are still coming, just less often. The June RPI stood at 101 (readings above 100 indicate expansion), 0.1 points higher than the previous month. Both the current situation and future expectations component now are indicating growth for the industry. The **<u>one item that still shows contraction is the customer traffic measure, which in June stood at 99.7</u>**. The customer traffic index has been **<u>in contraction territory for much of the last 18 months</u>**. Is this a cause of concern? It sure is for the companies that are contributing to the index. One of the main gripes we have with the index at this time is that we think it is heavily weighted towards incumbents in the industry. The reality is that there has been a large increase in new restaurant openings in the last two years, many of them independents or small regional chains. This has contributed to a general erosion in customer traffic at larger chains and explains why the customer traffic index above shows a decline. It may not mean that consumers are eating out less, rather than they are spreading their visits among more restaurants. In other words, don't get too bearish on the restaurant index reading alone but view it in the context of other macro factors. Income growth remains near long run trends, the economy is near full employment and job growth remains quite robust. Those are key drivers for meat demand and they are still quite positive.

But one should recognize **<u>the shifts that are currently taking place in the food industry</u>**. The second chart to the right offers another reason why customer counts may be down. In the last two years we have seen a wide gap open between food cost inflation at foodservice vs. grocery stores. Restaurants now have to cope with increased competition for both customers and labor. As a result they have used the savings from lower raw material costs to bolster wages and refurbish restaurants. Food cost inflation at foodsevice, both full service restaurants and fast food, has been steadily rising in the last two years even as raw material prices have declined. Food inflation at grocery stores, on the other hand, has declined, which may have caused shoppers to substitute some eating out nights with home cooked meals. Foodservice dollar sales have far outpaced grocery store sales in the last decade, evidence that US consumers still like to eat out. But if retailers have gained traffic thanks to lower prices, in our mind this would imply that summer retail promotions have gained more importance (higher foot traffic) for the meat industry. Something to consider when looking at the summer/fall seasonals.



Food CPI Comparisons. Jan 2008 = 100
Source: BLS. Analysis by Steiner Consulting



MONTHLY $ SALES AT GROCERY STORES AND FOODSERVICE ESTABLISHMENTS. BILLION DOLLARS
Source: US Census Advance Retail Sales Survey. Nominal Dollar Sales