

CONSUMERS – WHAT WE HEARD:

Interesting observations of consumer behavior now that many States have been easing the Shelter at Home mandates and opening back up for business.

1. People generally respond to polls and surveys with a very rational mindset but in real life their responses are driven more by emotion. Case in point – there have been a multitude of polls and surveys on consumers attitudes regarding Covid-19 and follow-up polls on how consumers would respond once the economy was reopened.

Poll after poll cited most consumers feared the Covid-19 virus and, as a result, most responded they would avoid large gatherings (60%) and restaurants' dine-in options (53%) for the unforeseeable future. But as we heard and saw, once the Shelter at Home mandates were lifted, those cautions and restraints did not exist. We heard of several incidents where restaurants opened and all of a sudden were overwhelmed with customers who didn't mind elbow to elbow contact. Also, as several coastal States opened up their beaches, we heard of several incidents where the crowds were so large that the authorities had to reclose the beach.

This past weekend we visited several grocery stores in our area and found less than 50% of employees were wearing masks properly (they had them pulled down around their neck) and that less than 20% of customers were wearing masks. Whereas, just a few days earlier, 90% of customers wore masks and all employees wore them. So much for rational caution. Pent up desire to get out proved more persuasive than rational caution.

According to Richard Curtin, Research Associate Professor at the University of Michigan Institute for Social Research, "...once the elevated risk (of the pandemic) disappears, economic theory holds consumers' pre-existing preferences would again determine their decisions with their economic behavior comparable to the past. What is missing in the analysis of people's choices is how emotion also shapes behavior. When ambiguous information prevents rational risk evaluations, as it did in the early stages of the virus, emotions serve as the functional equivalent of people's cognitive faculties. Long after a vaccine ends the pandemic, some people may still automatically attach negative evaluation to events that involve crowded venues (or excessive social contact). A key issue is whether these associations will fade over time or if it will represent a lasting impact similar to the Great Depression on that generation." The most important implication of the pandemic is how it will alter judgments regarding consumer's choices in the future.

With this in mind, we offer the following comments and observations with polls we trust.

- Several polls/surveys have formulated classifications for the post Crisis consumers (Gallup, Datassentials, and the Conference-Board). 10-15% of consumers do not plan on getting out in the public anytime soon. Another 10-15% comprise the group that never really worried or were concerned about the virus. And 70% are the group that have varying degrees of concern but plan on resuming socializing activities with differing degrees of caution and with little restraints.
- These 2 latter groups are where business owners need to focus their marketing efforts. The first group, those not planning on engaging in activities with large crowds, are primarily those consumers that are most vulnerable to the virus.
- Consumers' expectations and attitudes are changing and have been for quite some time but the Covid-19 Crisis has accelerated and shifted these changes in new directions. The perceptive operator will make adaptations to meet these new consumer demands.
- Many definitions of consumer behavior from the past have changed due to the Crisis. As in previous reports, "pent up demand" is one of the most significant definitions that has changed. Pre-Covid-19 pent up demand referred to consumers withholding spending for a variety of reasons and then an event takes place and consumers "rush" to spend. Most of these situations are economically driven. But with the

intrusion of the Covid-19 Crisis (which is a health related crisis), pent up demand now means a combination of spending and freedom of mobility restored.

- Other new post Covid-19 definitions for describing consumer behavior will be social distancing – a conscious avoidance of close contact with other people outside of your home environment. Consumers will be much more aware of people and surroundings.
- Several other key behavioral definition changes will be health concerns. This new awareness will have a big impact in consumer shifts in expectations and will now include observable efforts of staff cleaning frequently touched surfaces, wearing protective equipment (PPE), hand sanitizer at entrances and exits, staff following social distancing guidelines, and contactless options like ordering, paying, etc.
- Digital Transformation – the consumer is way ahead of most businesses with their expectations and comprehension of these innovations. Consumers of the new normal want digital with corresponding touchless business interactions.
- Consumers will demand restaurants to “know” them intensely, know what they expect, know what they want, and flawlessly deliver on these expectations. There will be greater demand on speed of service, especially for off-premise orders – if the customer has been told their order will be available/delivered in 30 minutes, that is exactly what they will expect; no tolerance for late orders in the future. Their order can be “perfect” and have the server mishandle the silverware (for dine-in) or forget to add silverware to take-out and the restaurant immediately falls from grace in the consumer’s eyes. Tolerance will be low for even the slightest error in the experience process and will be perceived as catastrophic to the consumer with harsh results.
- Trust – The top concern of consumers is centered on businesses gaining their trust in the post Covid-19 world. Getting the consumer to feel safe and secure from potential risks of catching the virus is going to be tough. It is important for operators to recognize this new priority and make plans to build their customer relationships with this as the key, and the benefits gained to ensure their new customer experience programs go above and beyond what is expected. Brands will have to work harder than before to recapture and strengthen consumer trust in order to build new long-term customer loyalty through trust.

At every contact point of the customers dining journey (and this includes and is more relevant for Take-Out and Delivery than ever before), the customer must observe if the restaurant is putting people (employees as well as customers) ahead of profits. And further, to gain their trust, businesses must deliver on their advertised promises – 100%. Not that they advertise one thing and the customer is provided with something else.

Trust is the connective tissue that binds together everything that we do: our relationships, our actions, our expectations of others. We expect institutions, businesses and other organizations to deliver on their promises and behave responsibly. We expect that we can move around our communities safely, depend upon our relationships, and rely on certain truths.

- Current income levels will also play a significant role in consumers plans to purchase as the economy reopens. According to recent Gallup poll, 46% of U.S. households have had their income impacted to some degree during the Crisis and it will take some time for this group to get back on their feet financially. So, until they do, their food purchases will be restricted and governed by value offers.
- Value – Prior to Covid-19 Crisis, consumers desire for “value” was mainly portrayed as an economic preference. Price was the key to making purchasing choices. But since the Crisis, the description of consumer value goes beyond an economic preference. Value now encompasses psychological “value” – make my life simpler. While the economic description is still relevant, “getting my money’s worth” is of more importance than cheaper pricing. (This is one of the reasons Starbucks Coffee outsells Dunkin’ Donut’s coffee. The consumer perceives Starbucks as having higher quality and thus they feel they get their money’s worth for the price.)

Another component to value, post Covid-19, will be the higher expectation consumers will put on the efficiency delivered to them in every step of their purchasing experience journey.

Most recent Consumer Sentiment Survey (University of Michigan Sentiment Survey):

May 13, 2020	April 2020
73.7	71.8

May 13, 2020 shows consumer confidence inching up. They attribute this in large part to the CARES relief checks being received and improving consumers' personal finances. This improvement in consumer confidence coincides with findings in several other polls that show consumers relaxing their overall attitude regarding the Covid-19 Crisis.

The Datassentials poll regarding consumers concern level about Covid-19 conducted multiple times per week during the pandemic (March 10, 2020 through May 14, 2020) shows a gradual decline (from the May 1 peak of 67% to 53% by May 14) indicating consumers are becoming less concerned as more details regarding the virus have become widely known. Additionally, Datassentials' other poll conducted simultaneously regarding consumers interest to "avoid" eating out once the economy reopens revealed the peak of avoidance was April 10 as 68% of consumers would definitely avoid eating out. As of May 14, the poll results show the decline to current levels of 51% (corresponding to the "concerns" poll mentioned above). Thus, we are seeing consumers relaxing their fears and concerns and increasing their willingness to eat (dine-in) at restaurants.

Some interesting results from various contacts (data also supplied by Womply credit card processing company) in States that have reopened dining rooms to include: Alabama, Arizona, Florida, Nebraska, South Carolina, Tennessee, Indiana, Georgia, Oklahoma, Kansas, Texas and Utah – these states are showing a lower percentage of daily sales average compared to March 1, 2020 (representing 100%) as follows:

Alabama	74%	Nebraska	85%	Indiana	84%	Kansas	63%
Arizona	72%	South Carolina	82%	Georgia	68%	Texas	68%
Florida	61%	Tennessee	79%	Oklahoma	80%	Utah	75%

- We're also hearing average check for dine-in spend is down approximately 44%. Not a real good start on rebuilding the business; but also shows consumers are selective in their spending and shopping plans.

OPERATORS/INDUSTRY:

Although no one could have predicted a global crisis like this was heading our way in 2020, restaurants have shown amazing resilience and ingenuity in the face of all the chaos. Many restaurants have been able to stay open with a take-out and delivery only business model. Menus have to change. Food preparation, plating, and packaging are definitely different. And the process of getting food into the hands of customers has evolved.

But that is not the only alternative food service option. Restaurants have converted to being grocers providing nutritious food options and essential household items quickly and safely. Bars package cocktails To-Go.

Science fiction writer, William Gibson, once said, "the future is here, but its not evenly distributed." We are vividly seeing that now with consumers, operators, and suppliers. We have seen examples from each group exhibit success and failures. Covid-19 Crisis has been the catalyst to accelerate the uncovering of the weaknesses in the pre Covid-19 respective business models. Now the pressure is on businesses to take advantage of technology and seize the opportunity to reset and make all business practices less complicated, more seamless – this will benefit all.

What we have seen and heard as the Covid-19 Crisis hit the restaurant industry were initial expressions of doom and gloom, no hope, no foreseeable way through this catastrophic event. Indeed, many "successful" independent restaurants have permanently closed their doors; in some cases, after as much as 20-30 years of successful existence.

The future seemed non-existent; but then inspiring stories began to emerge of restaurant operators fighting back to survive and it began with independents making adaptations to their core menu, switching to comfort foods rather than brand uniqueness, offering meal kits (cook and assemble at home), family meal bundles (feed a family of 4), where States allowed - selling beer and wine To-Go and in many instances selling prepared cocktails (in sealed containers), dressed up curbside with tents and high-quality packaging, greater community involvement by donating meals to front line responders. In general, operators' attitudes have shifted to more optimism than when the Crisis originally occurred.

A notable surge in innovation for the Fast Casual sector demonstrates their creativeness for off-premise sales as well. Chipotle actually began prior to the Covid-19 Crisis with multiple initiatives: Chipotalone, Designated Off-Premise Make-Up Line, Walk-Up Window (where possible). Habit with their Pop-Up Drive Thru's and Shake Shack with their Shack Tracks just to name a few.

(More details in our next report.)

SUPPLY CHAIN UPDATE:

The meat category of the supply chain – Despite the disruptions that have occurred in the food supply chain, the USDA does not expect any significant food shortages (reported on 5/15/20); although there has been “scarcity” in the pork and beef category which has had a limited impact on chains such as Wendy’s and Sonic. Several of the meat processing plants that were closed due to Covid-19 issues have reopened and once again begun production. This will certainly help but does not fill the gap created with the plant closures. Additionally, the USDA has been working with cattle and pork ranchers to get them better prices. There is still the price gap we discussed in our last report. This has caused higher prices for consumers and restaurants and several cuts of beef and pork are not available. The flip side is that retail, grocery store chains continue to limit purchases of beef, chicken and pork.

As of 9:00 AM May 18, 2020 – The USDA has been approved to release Covid-19 relief payments for farmers. Part of this relief payment has the USDA purchasing \$470 million in surplus meat in an effort to bolster price stability for farmers and to provide them some immediate income. This is a major step toward encouraging farmers to accelerate supplying beef and pork to processors.

We expect the food supply chain of the future will look much different as supply chain leaders reassess pre Covid-19 models and adjust them to incorporate more redundancies and we foresee chains seeking multiple sources for suppliers in the future.

For the restaurants, we expect to see changes in relying on one major source for distribution and product specificity and secondly, requiring suppliers to maintain a larger on-hand inventory of the restaurants’ products are among the most significant changes.

News update as of May 19, 2020 – Several agriculture commissioners on ArrowStream’s webinar on Tuesday, May 19, 2020 stated that beef and pork production are up (beef up 10%; pork up 9%) since their lowest point during the Crisis. Certainly a good indication that the supply is coming back.

(Updates in our next report.)