



**What's Inside This Commentary**

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**Same-store sales discussion**

During the first quarter of 2017 ("Q1 2017"), the restaurant industry saw generally soft performance in same-store sales ("SSS"). On average, restaurant same-store sales decreased 0.8% year-over-year ("YOY") in Q1 2017. In fact, of the 69 companies that we follow, only 28, or 40%, enjoyed positive same-store sales growth in Q1 2017. Data over the last several quarters have showed a consistent slowdown for the industry. Q1 2017 extended the streak of industry SSS decreases to four (4) quarters.

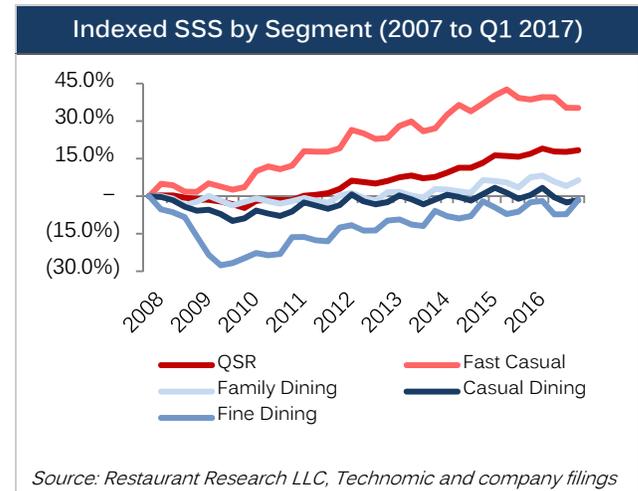
**QSR:** In the QSR segment, 14 of the 23 concepts we track showed positive same-store sales growth during Q1 2017, with the segment as a whole flat YOY. Sandwich concepts within QSR were a mixed bag with a few brands up and a few brands down for an average decrease of 0.9%, driven by a 7.4% decrease at Sonic. After growing SSS by 6.4% in Q1 2016, Domino's had another stellar quarter with 10.2% growth in Q1 2017. The pizza giant has delivered double-digit SSS growth in 8 of the past 10 quarters.

**Fast Casual:** Among the fast casual concepts we track, the two largest, Chipotle and Panera, were the only brands to show SSS growth in Q1 2017. Chipotle bounced back with 17.8% SSS growth after five consecutive quarters of sales decreases on the heels of its food safety issues. Despite the improvement, Chipotle's Q1 sales are still down approximately 17% on a two-year basis. Panera delivered another quarter of SSS growth with a 2.6% gain. The other eight (8) fast casual brands we track all had SSS decreases for the quarter. Worst off was Pie Five as their struggles continued with a decrease of 15.8%. After 25 quarters of SSS growth, the fast casual segment has had negative performance the last five (5) quarters. In Q1 2017, SSS declined 1.1% YOY. Excluding Chipotle and Pie Five, the segment was down 1.6% YOY. This marks the second consecutive quarter that a majority of the fast casual concepts we track had negative sales comps.

**Family Dining:** Struggles for the family dining segment worsened in Q1 2017 as all seven (7) concepts we track posted SSS decreases. After 11 quarters of growth for the segment as a whole, this marks the second consecutive quarter of decreases.

**Casual Dining:** Downward trends in casual dining continued in Q1 2017 as SSS declined 1.2% YOY. Of the 24 concepts we follow, 13 experienced sales declines for the quarter. The largest player was hardest hit as Applebee's saw a 7.9% SSS decrease, its seventh consecutive quarterly decrease. Conversely, Texas Roadhouse continued its strong run and led the casual dining segment with 3.2% SSS growth, its 29th consecutive quarter of SSS growth dating back to Q1 2010.

**Fine Dining:** The fine dining segment saw a SSS decrease of 0.2% YOY on negative comps from three of five concepts we track in Q1 2017. As the chart below illustrates, fine dining sales are close to pre-recession levels and are now only 2.2% below 2008 sales. Fleming's lagged the segment in Q1 2017 with a 2.9% same-store sales decrease.



Overall, the restaurant industry's same-store sales performance in Q1 2017 was lackluster, and the negative trends continued to gain momentum. It is difficult to identify the specific factors causing this downward trend in guest traffic and sales across all restaurant segments, as many key economic indicators such as unemployment, household income and consumer confidence signal continued, albeit slow, economic improvement. Perhaps the trend in the restaurant industry is foreshadowing a tougher economic environment.

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**Same-Store Sales Data**

	FY 2014			FY 2015				FY 2016				FY 2017
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>QSR</b>												
<b>Chicken</b>												
Bojangles	4.2%	5.3%	7.0%	7.9%	4.4%	4.1%	0.6%	2.0%	0.2%	0.8%	2.4%	(1.7%)
Church's	0.3%	1.7%	3.6%	2.8%	(2.6%)	(4.8%)	(4.6%)	(4.2%)	(2.5%)	(1.8%)	(1.3%)	(1.0%)
KFC	(2.0%)	2.0%	6.0%	7.0%	3.0%	0.0%	3.0%	1.0%	2.0%	6.0%	4.0%	2.0%
Pollo Tropical	6.7%	5.9%	7.7%	6.4%	4.3%	4.2%	0.4%	0.0%	(1.4%)	(1.0%)	(4.0%)	(6.7%)
Popeye's	3.8%	7.2%	10.7%	7.0%	7.9%	5.6%	2.0%	1.1%	0.0%	1.5%	3.0%	(0.4%)
<b>Mean</b>	<b>2.6%</b>	<b>4.4%</b>	<b>7.0%</b>	<b>6.2%</b>	<b>3.4%</b>	<b>1.8%</b>	<b>0.3%</b>	<b>(0.0%)</b>	<b>(0.3%)</b>	<b>1.1%</b>	<b>0.8%</b>	<b>(1.6%)</b>
<b>Coffee/Snack</b>												
Baskin Robbins	4.2%	5.8%	9.3%	8.0%	3.4%	7.5%	4.4%	5.0%	0.6%	(0.9%)	0.9%	(2.4%)
Dunkin Donuts	1.8%	2.0%	1.4%	2.7%	2.9%	1.1%	1.8%	2.0%	0.5%	2.0%	1.9%	0.0%
Jamba Juice	2.5%	3.7%	4.9%	5.0%	(5.9%)	6.6%	5.4%	(2.1%)	4.2%	(1.1%)	(2.2%)	0.0%
Starbucks	6.0%	5.0%	5.0%	7.0%	8.0%	9.0%	9.0%	7.0%	4.0%	4.0%	3.0%	3.0%
Tim Horton's	5.9%	6.8%	4.1%	8.9%	7.0%	4.3%	5.8%	5.8%	5.9%	4.5%	3.6%	(0.1%)
<b>Mean</b>	<b>4.1%</b>	<b>4.7%</b>	<b>4.9%</b>	<b>6.3%</b>	<b>3.1%</b>	<b>5.7%</b>	<b>5.3%</b>	<b>3.5%</b>	<b>3.0%</b>	<b>1.7%</b>	<b>1.4%</b>	<b>0.1%</b>
<b>Mexican</b>												
Del Taco	N/A	N/A	N/A	7.7%	6.0%	5.6%	5.8%	3.2%	3.3%	6.7%	5.5%	4.2%
Taco Bell	2.0%	3.0%	7.0%	6.0%	6.0%	4.0%	4.0%	1.0%	(1.0%)	3.0%	3.0%	8.0%
<b>Mean</b>	<b>2.0%</b>	<b>3.0%</b>	<b>7.0%</b>	<b>6.9%</b>	<b>6.0%</b>	<b>4.8%</b>	<b>4.9%</b>	<b>2.1%</b>	<b>1.2%</b>	<b>4.9%</b>	<b>4.3%</b>	<b>6.1%</b>
<b>Pizza</b>												
Domino's	5.4%	7.7%	11.1%	14.5%	12.8%	10.5%	10.7%	6.4%	9.7%	13.0%	12.2%	10.2%
Papa John's	6.0%	7.4%	4.1%	6.5%	5.5%	3.0%	1.9%	0.1%	4.8%	5.5%	3.8%	2.0%
Papa Murphy's	1.5%	1.5%	N/A	5.6%	4.5%	1.4%	(3.1%)	(3.0%)	(4.0%)	(5.8%)	(7.8%)	(5.0%)
Pizza Hut	(4.0%)	(2.0%)	0.0%	(1.0%)	1.0%	0.0%	2.0%	5.0%	1.0%	(2.0%)	(4.0%)	(7.0%)
Pizza Inn	N/A	4.6%	6.4%	6.0%	0.2%	(1.1%)	(1.7%)	(2.2%)	0.3%	0.2%	(1.2%)	0.1%
<b>Mean</b>	<b>2.2%</b>	<b>3.8%</b>	<b>5.4%</b>	<b>6.3%</b>	<b>4.8%</b>	<b>2.8%</b>	<b>2.0%</b>	<b>1.3%</b>	<b>2.4%</b>	<b>2.2%</b>	<b>0.6%</b>	<b>0.1%</b>
<b>Sandwich</b>												
Arby's	6.3%	10.4%	4.9%	9.7%	7.6%	9.6%	5.5%	5.8%	3.7%	2.4%	3.1%	1.6%
Burger King	0.4%	3.6%	4.2%	6.9%	7.9%	5.2%	2.8%	4.4%	(0.8%)	(0.5%)	1.8%	(2.2%)
Jack in the Box	2.4%	3.1%	4.4%	8.9%	7.3%	6.2%	1.4%	0.0%	1.1%	2.0%	3.1%	(0.8%)
McDonald's	(1.5%)	(3.3%)	(1.7%)	(2.6%)	(2.0%)	0.9%	5.7%	5.4%	1.8%	1.3%	(1.3%)	1.7%
Sonic Drive-In	5.3%	3.5%	8.5%	11.5%	6.1%	4.9%	5.3%	6.5%	2.0%	(2.0%)	(2.0%)	(7.4%)
Wendy's	3.2%	0.8%	1.7%	3.2%	2.2%	3.1%	4.8%	3.6%	0.4%	1.4%	0.8%	1.6%
<b>Mean</b>	<b>2.7%</b>	<b>3.0%</b>	<b>3.7%</b>	<b>6.3%</b>	<b>4.9%</b>	<b>5.0%</b>	<b>4.3%</b>	<b>4.3%</b>	<b>1.4%</b>	<b>0.8%</b>	<b>0.9%</b>	<b>(0.9%)</b>
<b>Mean Total QSR</b>	<b>2.9%</b>	<b>3.9%</b>	<b>5.3%</b>	<b>6.3%</b>	<b>4.2%</b>	<b>4.0%</b>	<b>3.2%</b>	<b>2.3%</b>	<b>1.6%</b>	<b>1.7%</b>	<b>1.2%</b>	<b>(0.0%)</b>
<b>Fast Casual</b>												
Chipotle	17.3%	19.8%	16.1%	10.4%	4.3%	2.6%	(14.6%)	(29.7%)	(23.6%)	(21.9%)	(4.8%)	17.8%
El Pollo Loco	5.5%	7.9%	7.6%	3.5%	1.3%	0.0%	1.8%	0.7%	2.4%	1.6%	(1.3%)	(0.3%)
Fuddrucker's	(3.9%)	(4.6%)	0.2%	2.1%	0.2%	1.7%	1.3%	0.0%	(1.0%)	(0.8%)	(1.6%)	(1.1%)
Noodles & Company	0.2%	1.7%	1.3%	0.9%	0.1%	(0.9%)	(1.1%)	(0.1%)	(1.0%)	(0.7%)	(1.3%)	(2.0%)
Panera Bread	0.1%	1.4%	3.0%	0.7%	1.8%	2.8%	2.3%	4.7%	2.3%	1.7%	0.7%	2.6%
Pie Five	12.9%	17.0%	16.9%	9.5%	6.7%	1.5%	(1.6%)	(4.0%)	(12.0%)	(14.7%)	(17.4%)	(15.8%)
Potbelly	(1.6%)	0.5%	3.7%	5.4%	4.9%	3.7%	3.7%	3.7%	1.7%	0.6%	0.1%	(3.1%)
Qdoba Mexican Grill	7.5%	7.7%	14.0%	8.3%	7.7%	6.6%	1.5%	2.1%	0.6%	0.8%	(1.0%)	(3.2%)
Shake Shack	N/A	N/A	7.2%	11.7%	12.9%	17.1%	11.0%	9.9%	4.5%	2.9%	1.6%	(2.5%)
Zoe's Kitchen	7.5%	5.9%	7.8%	N/A	5.6%	4.5%	7.7%	8.1%	4.0%	2.4%	0.7%	(3.3%)
<b>Mean</b>	<b>5.1%</b>	<b>6.4%</b>	<b>7.8%</b>	<b>5.8%</b>	<b>4.6%</b>	<b>4.0%</b>	<b>1.2%</b>	<b>(0.5%)</b>	<b>(2.2%)</b>	<b>(2.8%)</b>	<b>(2.4%)</b>	<b>(1.1%)</b>

Source: Restaurant Research LLC, Capital IQ, Technomic and company filings

**Same-Store Sales Data (Cont.)**

	FY 2014			FY 2015				FY 2016				FY 2017
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>Family Dining</b>												
Bob Evans	(2.0%)	0.0%	3.8%	2.1%	(0.3%)	(3.2%)	(3.6%)	(3.0%)	(2.0%)	(2.2%)	(2.6%)	(3.9%)
Chuck E Cheese	N/A	N/A	(1.4%)	(5.0%)	3.0%	0.7%	1.3%	6.0%	2.6%	3.7%	(1.6%)	(2.8%)
Cracker Barrel	1.3%	3.3%	7.9%	5.2%	3.8%	2.5%	0.6%	2.3%	3.2%	1.3%	0.6%	(0.4%)
Denny's	1.9%	2.4%	4.7%	7.2%	7.3%	6.1%	2.9%	2.5%	(0.5%)	1.0%	0.5%	(1.1%)
IHOP	3.2%	2.4%	6.1%	4.8%	6.2%	5.8%	1.4%	1.5%	0.2%	(0.1%)	(2.1%)	(1.7%)
Luby's	2.0%	0.4%	0.2%	3.1%	(1.0%)	0.2%	1.2%	3.1%	(0.2%)	0.0%	(2.2%)	(4.4%)
Steak n Shake	3.7%	2.6%	2.9%	6.0%	4.8%	3.0%	3.6%	1.8%	(0.7%)	0.2%	(0.4%)	(3.3%)
<b>Mean</b>	<b>1.7%</b>	<b>1.9%</b>	<b>3.5%</b>	<b>3.3%</b>	<b>3.4%</b>	<b>2.2%</b>	<b>1.1%</b>	<b>2.0%</b>	<b>0.4%</b>	<b>0.6%</b>	<b>(1.1%)</b>	<b>(2.5%)</b>
<b>Casual Dining</b>												
Applebee's	0.6%	1.7%	2.8%	2.9%	1.0%	(0.5%)	(2.5%)	(3.7%)	(4.2%)	(5.2%)	(7.2%)	(7.9%)
Bahama Breeze	4.1%	N/A	(0.6%)	3.2%	1.8%	1.8%	2.4%	9.9%	4.7%	3.9%	2.6%	0.5%
BJ's Restaurants	(1.7%)	0.3%	1.2%	3.2%	0.5%	2.3%	0.7%	0.6%	(0.2%)	(3.4%)	(2.2%)	(1.3%)
Bonfish	0.3%	2.6%	0.7%	0.9%	(4.6%)	(6.1%)	(5.4%)	(2.7%)	0.9%	1.7%	(1.9%)	(0.8%)
Bravo! Cucina Italiana	(6.0%)	(6.7%)	(3.9%)	(1.7%)	(2.1%)	(3.1%)	(5.2%)	(4.1%)	(8.4%)	(8.0%)	(7.5%)	(2.9%)
Brick House Tavern	8.5%	7.5%	5.7%	5.4%	2.8%	(0.7%)	(2.8%)	(4.5%)	(6.3%)	(8.9%)	0.0%	0.0%
Brio Tuscan Grille	(4.5%)	(5.2%)	(4.2%)	(1.0%)	(1.6%)	(3.8%)	(4.3%)	(2.1%)	(6.4%)	(3.7%)	(4.3%)	(1.9%)
Buffalo Wild Wings	7.0%	5.8%	5.5%	6.5%	3.3%	2.6%	1.0%	(2.0%)	(2.3%)	(1.7%)	(4.0%)	0.6%
Carrabba's Italian Grill	(1.2%)	(1.2%)	0.3%	1.9%	0.9%	(2.0%)	(4.0%)	(2.0%)	(4.8%)	(2.1%)	(2.3%)	(3.8%)
Cheesecake Factory	1.5%	2.1%	1.4%	4.2%	2.8%	2.2%	1.1%	1.7%	0.3%	1.7%	1.1%	0.3%
Chili's Grill & Bar	2.5%	2.3%	4.2%	2.2%	0.1%	(1.1%)	(2.1%)	(3.6%)	(1.8%)	(1.3%)	(3.2%)	(1.7%)
Chuy's	2.4%	3.0%	3.8%	1.9%	N/A	4.2%	3.2%	3.2%	1.0%	0.3%	(1.1%)	(0.7%)
Dave & Buster's	4.7%	8.7%	10.5%	9.9%	11.0%	8.8%	6.0%	3.6%	1.0%	5.9%	3.2%	2.2%
Famous Dave's	(2.8%)	(2.3%)	(2.4%)	0.1%	(3.3%)	(3.6%)	(5.2%)	(6.1%)	(4.3%)	(3.8%)	(4.7%)	(4.8%)
Joe's Crab Shack	(4.7%)	(4.4%)	(4.5%)	(3.8%)	(4.0%)	(6.6%)	(2.9%)	(1.3%)	(6.8%)	(6.5%)	0.0%	0.0%
Kona Grill	3.2%	2.7%	3.1%	2.2%	1.0%	1.6%	3.2%	3.6%	2.5%	0.7%	(4.1%)	(4.3%)
LongHorn Steakhouse	2.4%	2.8%	2.6%	5.4%	5.2%	4.4%	2.6%	5.2%	2.2%	0.6%	0.1%	0.2%
Maggiano's	0.9%	0.6%	2.3%	0.1%	(0.1%)	(1.7%)	(1.8%)	0.2%	(1.7%)	(0.6%)	(0.8%)	1.6%
Olive Garden	(4.2%)	(1.3%)	2.2%	2.2%	3.4%	2.7%	2.8%	4.9%	2.4%	2.0%	2.6%	1.4%
Outback	0.9%	4.8%	6.4%	5.0%	4.0%	0.1%	(2.2%)	(1.3%)	(2.5%)	(0.7%)	(4.8%)	1.4%
Red Robin	1.6%	1.4%	4.3%	3.8%	3.6%	3.7%	(1.6%)	(2.2%)	(3.2%)	(3.3%)	(4.4%)	(1.5%)
Ruby Tuesday	0.4%	1.1%	(1.0%)	(0.3%)	(1.7%)	0.6%	0.8%	(3.1%)	(3.7%)	(2.7%)	(4.1%)	(4.0%)
Taco Cabana	2.8%	3.5%	6.1%	3.8%	5.6%	4.8%	3.3%	1.7%	(3.8%)	(4.1%)	(3.5%)	(4.5%)
Texas Roadhouse	3.0%	5.8%	6.8%	8.7%	8.0%	7.0%	4.4%	4.3%	4.2%	3.4%	1.4%	3.2%
<b>Mean</b>	<b>0.9%</b>	<b>1.5%</b>	<b>2.2%</b>	<b>2.8%</b>	<b>1.6%</b>	<b>0.7%</b>	<b>(0.4%)</b>	<b>0.0%</b>	<b>(1.7%)</b>	<b>(1.5%)</b>	<b>(2.0%)</b>	<b>(1.2%)</b>
<b>Fine Dining</b>												
Fleming's	3.6%	4.8%	3.4%	3.0%	3.2%	(0.6%)	(0.3%)	1.3%	(0.8%)	(1.9%)	0.2%	(2.9%)
Ruth's Chris	2.8%	4.8%	5.0%	2.8%	4.2%	3.3%	3.2%	3.1%	1.5%	2.1%	0.0%	0.7%
Capital Grille	0.8%	3.9%	5.0%	6.1%	4.4%	7.2%	1.5%	5.3%	3.7%	(1.2%)	1.2%	0.9%
Del Frisco's	5.2%	8.4%	4.9%	2.3%	1.0%	(1.4%)	(4.5%)	5.3%	(2.0%)	(1.4%)	2.7%	(0.9%)
Sullivan's	0.9%	0.6%	1.7%	4.8%	(3.0%)	1.2%	(1.8%)	(1.8%)	(2.9%)	(3.2%)	0.9%	1.1%
<b>Mean</b>	<b>2.7%</b>	<b>4.5%</b>	<b>4.0%</b>	<b>3.8%</b>	<b>2.0%</b>	<b>1.9%</b>	<b>(0.4%)</b>	<b>2.6%</b>	<b>(0.1%)</b>	<b>(1.1%)</b>	<b>1.0%</b>	<b>(0.2%)</b>

Source: Restaurant Research LLC, Capital IQ, Technomic and company filings

## It's the economy, stupid.

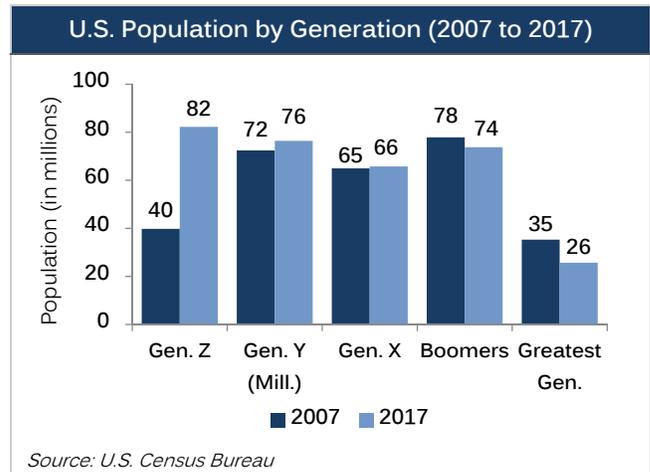
Many of us remember James Carville's observation that the slogan "It's the economy, stupid" was the most effective message for Bill Clinton in his campaign against George H. Bush in the 1992 presidential election. The economy was still in a mild recession and many politicians were not focused on that in the 1992 election cycle. In retrospect, the sentiment seemed obvious, but not everyone was paying attention to the tea leaves – and that is exactly what's going on right now with declining restaurant sales. Lower middle-class and working-class workers have significantly less buying power than they had 10 years ago and are quietly spending less in restaurants. But restaurant companies continue to raise prices pushing lower middle and working-class families further away from dining out. Another way of looking at it is the number of restaurant visits that can be funded with \$50,000 of household income is fewer today than it was 10 years ago. There is plenty of empirical evidence to support this.

Asset prices plummeted during the Great Recession in 2009 and then eventually recovered. Much of this recovery was funded by the government through its stimulus program and Federal Reserve bailouts of Freddie Mac, Fannie Mae, General Motors, AIG and others. Meanwhile, in the background, the vestiges of 25 years of liberal trade agreements and technological advances have robbed the country of many high-paying working-class and lower middle-class jobs. Manufacturing by US companies still takes place, but a lion's share of the work is done overseas at a fraction of the labor cost. The question is which is more beneficial for the restaurant industry: lower-priced goods from foreign workers or higher wages and buying power in the lower middle- and working-class?

Many public restaurant companies have aggressively raised prices during the time since the Great Recession. This has exacerbated their troubles because value and price point are one of the most important things to consumers when they decide whether to eat at home or go out, and if they go out, where to eat. A meal for four diners with entrées, appetizers and drinks is over \$100 in most US chains (after tip and tax). For the average middle-class family with two leased cars in the driveway, a variable-rate mortgage, which has been going up, and MasterCard, Visa, AMEX and Discover cards in their wallet, the \$100 price point has reduced family sit-down restaurant occasions from seven to six per year. This is borne out by the

cumulative 20% traffic decline in Knapp-Track, which has still not recovered to the 2007 levels.

Casual dining, in particular, has been slow to meet the challenges of both a softening economy and the demographic impact of an aging population. Legacy concepts entrenched in Baby Boomer and Greatest Generation customers are marketing to 30% of the population as opposed to the letter generation, which compose 70% of the population. As shown in the following chart, the population of Greatest Generation and Baby Boomers has decreased by approximately 15 million since 2007, and many more elderly diners have substantially cut back occasions for financial and age/health reasons. Unfortunately, this traffic has not been replaced with Gen X or Millennials because many of the casual dining chains are not attractive to Millennials.



Partially as a result of these demographic trends, there are 35 sit-down restaurant chains in bankruptcy right now, and sooner or later this and other soft concept traffic will migrate to the large-scale providers. The winners will be those who are able to retain their hold on Boomers and the Greatest Generation while making inroads with Gen X and Millennials. This transition is complex, costly and difficult and must be carefully managed. Moving too quickly runs the risk of alienating existing customers and potentially winding up with nothing. The key to this will be products and advertising that are tailored for each demographic group.

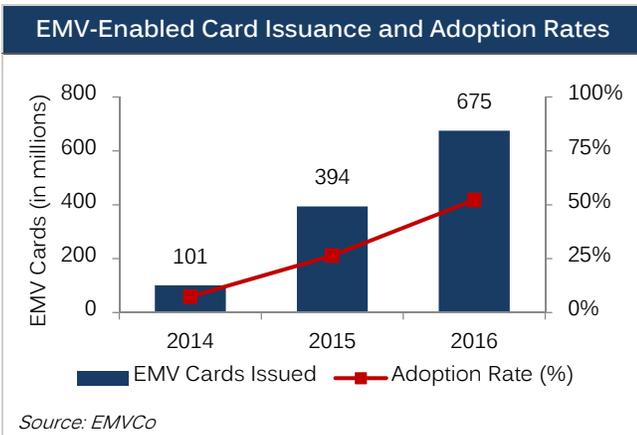
The casual dining segment has not had a positive sales month since February 2016 and we are fast approaching an environment where there is a strong likelihood of increased interest rates, falling cable and network viewership, rising commodity prices and declining industry-wide traffic.

This is not bad news for every single concept, it is simply a referendum that customers will continue to be harder to lure through media and more difficult to win and retain. Increasing prices is not the answer in this environment, value is! And a soft economy will not be the restaurant operator’s friend along the way.

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## Why have restaurants been slow adopters of chip-enabled cards?

As the prevalence of credit card fraud and data breaches lingers in the minds of the U.S. consumers, the adoption (and particularly the utilization) of EMV (Europay, Mastercard, and Visa) or “chip” cards continues to lag its original estimates. According to EMVCo, in Q4 2016 approximately 675 million EMV-enabled cards were issued, or an adoption rate of approximately 52%; however, only 19% of card-present transactions were EMV in the U.S. during 2016.



Chip-enabled cards are designed to be far more secure than outdated magnetic strips because of the encrypted chip which is much more complex and difficult to counterfeit. Many of the large national retail chains (e.g. Target and Home Depot) have taken efforts to combat fraud by upgrading their payment terminals to be EMV compliant; however, it has been noted that restaurants and hospitality merchants are among the slowest adopters of EMV.

Many operators of restaurants have trouble seeing the benefits of equipping their restaurants with EMV payment terminals. Technically, there are no legal requirements for upgrading to EMV-ready terminals, but fraud liability shifted from issuers to

merchants who have not opted to upgrade on October 1, 2015. At an average cost of approximately \$200 per terminal (even more for NFC-capable terminals to accommodate Apple Pay and Samsung Pay) and complying with the complex certification requirements, many operators wonder if upgrading is worth it. Let’s take a look at the benefits and concerns from the perspectives of groups of restaurant operators.

### Limited Service: Quick Service and Fast Casual

For QSR and fast casual operators, EMV-ready terminal adoption has lagged other retailers primarily due to speed of service impacts, lack of transparent benefits to their bottom line and worry over technology becoming obsolete.

Speed of service and transaction volume is highly important to consumers in this segment. The perceived “extra steps” of dipping your card into a terminal and waiting additional seconds for the authentication process of chip-enabled cards to occur slows down the overall transaction speed and impedes the flow of traffic. To alleviate some of the slowdown, many operators with EMV-enabled terminals have opted to eliminate customer signatures under a certain dollar threshold to increase customer satisfaction.

Additionally, average spend per transaction is relatively low in this segment, which translates into smaller chargebacks from the issuer to merchants compared to traditional and high-end retailers. Currently, for transactions under \$25, the main issuers, including Visa and American Express, have given reprieve on chargebacks to merchants until April 2018. The adoption of these new terminals may increase when this threshold lapses and issuers crack down on fraud at smaller transaction amounts.

Lastly, operators are worried about the rapid change of technology and their upgraded EMV-capable terminals becoming obsolete. Millennials are increasingly seeking the ability for transactions to be safe, fast and seamless and wanting to leave your wallets behind in lieu of near field communication (NFC) technologies, such as Apple Pay and Samsung Pay, and smartphone payment applications, such as the Starbucks app.

### Full-Service: Family Dining, Casual Dining and Fine Dining

Operators in the full-service restaurant category have greater benefits of managing chargebacks as their average check size tends to exceed the \$25 threshold of the major card issuers. However, despite this benefit, operators in this segment have

adopted EMV-capable technology less than those in the limited-service category. This is mainly due to dynamics of customer tipping and the shift in transaction method diners may have to adopt in the United States.

For chip-enabled cards, EMV standards are designed for these cards to remain in the control and sight of the cardholder at all times. This means that the staff at these establishments are supposed to conduct the payment process in front of the customer and not take their card to process the charge out of their sight. The idea of completing a transaction at the table and entering a tip in front of the waiter or waitress is a foreign concept to diners in the United States (whereas this is a common practice in Europe). To combat this element, several processors have developed applications called “tip adjust” to allow cardholders to pay and tip for a meal similar to the way they would using the magnetic strip. Nonetheless, the change in customer experience and relatively low impact of credit card fraud at these establishments have been enough to deter operators from widely adopting this newer, more secure payment technology.

#### *EMV Adoption Outlook*

While the liability shift in October 2015 was not a significant enough push for restaurant operators to adopt EMV-capable systems, it is likely for more restaurants to upgrade their payment technology as they are further educated, a greater percentage of chip-enabled cards are issued, more incentives are given to merchants for transitioning and implementation becomes easier. For example, Visa is exploring ways to make the transition simpler for restaurants by allowing them to “self-certify” their systems or allowing units of a restaurant chain to be certified for chip card charges if their equipment is identical to what is being used in branches that have already secured approval.

In conclusion, as Millennials continue to drive restaurant traffic, it seems to be only a matter of time before newer payment technologies (EMV, smartphone applications or NFC) will be widely implemented and provide the most secure and seamless transactions for restaurant operators.

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