TRINITY CAPITAL
INVESTMENT BANKING

1st Quarter 2013

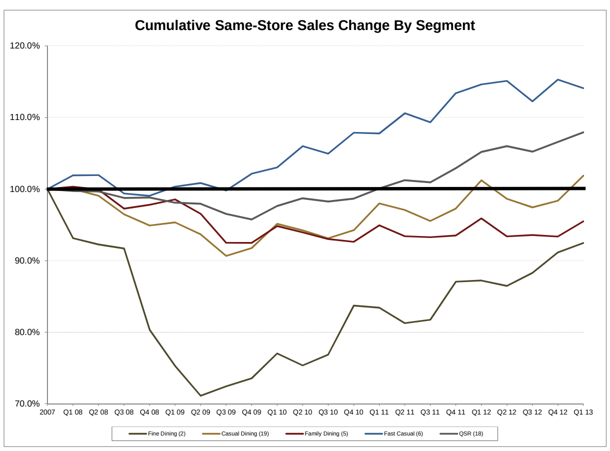
Restaurant Industry Commentary

What's Inside This Commentary

Same-Store Sales Discussion and Analysis

The first quarter of 2013 maintained the positive momentum in same-store sales, which is impressive as we continue to comp over positive results from the prior two years. The restaurant industry reported its twelfth consecutive quarter of same store sales gains. It should be noted, however, that traffic has recently slowed or declined within many prominent chains.

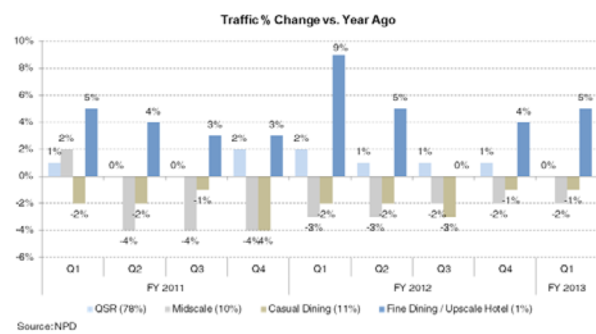
In fine dining, the companies we track were up from 2012 by an average of 6.0% for the first quarter of 2013. It is important to note that fine dining sales still continue to be well below pre-recession levels as these positive percentage increases are much lower than the dramatic percentage declines the segment experienced during 2009 and early 2010. Nonetheless, these gains represent real momentum given the last two years' positive results.



In casual dining, the concepts we follow were up by an average of 0.6% for the first quarter of 2013. This is the twelfth consecutive quarter that the casual dining segment has posted positive quarterly same-store sales growth. However, according to Knapp Track, casual dining guest counts were down by 2.1% in January, down by 5.9% in February and up by 1.1% in March. In fact, Knapp Track has reported negative guest counts in 17 of the last 20 months. The family dining concepts we track reported an average decrease in same-store sales of 0.4% during the first quarter of 2013.

The fast casual segment reported negative same-store sales performance for the first time since the second quarter of 2009. The segment was down by 0.4% for the first quarter of 2013. The negative comps in the fast casual segment are not surprising since the segment had been up for 14 consecutive quarters, and it is difficult to continue to comp up over such strong numbers.

In the QSR segment, 15 of the 18 concepts we track were positive during the first quarter of 2013 while the segment was up by an average of 2.6%. The Coffee/Snack segment had a strong showing in the first quarter, up by an average of 5.9% with Krispy Kreme leading the way, up 11.4%, followed by Starbucks, up 7.0%.



Steady traffic at quick service restaurants (78% of foodservice industry visits), and 5% traffic gains at fine dining/upscale hotel restaurants offset the losses at casual dining and midscale/family dining restaurants. The small gains in traffic compared to the larger gains in same-store sales suggests that concepts are increasing prices to generate the gains as opposed to increasing customer visits. NPD forecasts that restaurant traffic will be flat and spending will increase by 2.7 percent by year end. Therefore, price and spending will continue to drive growth, not transactions.

Contributing Editor Josh Brannan is a Vice President for Trinity Capital.

Same-Store Sales ("SSS") Data

	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fine Dining:									
Fleming's	11.4%	9.9%	10.1%	0.3%	5.4%	6.8%	10.1%	4.0%	5.4%
Ruth's Chris	5.2%	5.8%	2.6%	7.7%	3.7%	6.0%	5.9%	5.4%	6.6%
Mean	**8.3%**	**7.9%**	**6.4%**	**4.0%**	**4.6%**	**6.4%**	**8.0%**	**4.7%**	**6.0%**
Casual Dining:									
Applebee's	3.9%	3.1%	-0.3%	1.0%	1.2%	0.4%	2.0%	0.9%	-1.3%
Benihana	5.6%	6.0%	6.4%	7.0%	4.8%	4.5%	-	-	-
BJ's Resturants	7.8%	6.9%	6.5%	5.1%	3.3%	4.4%	2.3%	3.0%	-0.4%
Bonefish	9.6%	10.2%	7.4%	5.9%	6.2%	2.1%	3.5%	1.0%	6.2%
Buffalo Wild Wings	2.4%	3.9%	4.8%	7.1%	8.1%	5.4%	6.0%	6.7%	1.9%
Carrabba's Italian Grill	3.9%	4.8%	6.3%	3.5%	4.3%	1.5%	1.0%	-0.4%	4.3%
CEC Entertainment	1.1%	-2.0%	-6.3%	-3.6%	-4.2%	-2.4%	-2.3%	-2.9%	1.6%
Cheesecake Factory	2.1%	2.3%	0.8%	2.7%	2.6%	2.1%	2.9%	1.3%	1.6%
Chili's Grill & Bar	-3.0%	2.1%	1.7%	1.4%	4.6%	2.2%	2.8%	1.0%	-1.1%
Dave & Buster's	5.3%	1.9%	2.7%	-0.9%	-0.3%	5.4%	5.4%	-	-
Famous Dave's	3.0%	-1.2%	-0.1%	3.6%	-1.6%	-0.6%	0.2%	-6.0%	1.8%
Granite City	3.8%	3.5%	3.0%	4.0%	1.9%	1.5%	2.5%	4.5%	2.7%
LongHorn Steakhouse	6.1%	6.0%	4.8%	6.7%	3.8%	3.0%	2.2%	-0.8%	-1.6%
Maggiano's	3.4%	5.7%	3.5%	2.8%	3.9%	1.9%	0.9%	0.6%	0.4%
Olive Garden	0.0%	0.0%	-2.9%	-2.5%	2.0%	-1.8%	0.3%	-3.2%	-4.1%
Outback	4.3%	1.8%	6.0%	3.6%	5.3%	2.3%	4.5%	5.3%	2.5%
Red Lobster	0.1%	3.8%	10.7%	6.8%	6.0%	-3.9%	-2.6%	-2.7%	-6.6%
Red Robin	2.1%	2.9%	2.1%	4.5%	1.0%	1.2%	0.6%	1.4%	1.4%
Ruby Tuesday	-1.2%	-0.1%	-4.1%	-4.2%	-5.0%	-4.6%	1.9%	0.3%	-2.8%
Taco Cabana	2.0%	4.5%	5.3%	2.7%	6.1%	4.5%	1.8%	6.8%	2.0%
Texas Roadhouse	4.5%	4.3%	3.9%	5.6%	6.2%	4.6%	3.9%	4.5%	3.7%
Mean	**3.0%**	**3.0%**	**2.6%**	**3.2%**	**3.3%**	**1.6%**	**2.0%**	**1.1%**	**0.6%**
Family Dining:									
Bob Evans	1.2%	-1.8%	-1.5%	1.6%	-0.6%	1.0%	1.0%	1.6%	0.0%
Denny's	-1.7%	2.0%	0.9%	1.6%	2.4%	0.8%	0.4%	1.7%	-0.7%
Frisch's Big Boy	0.2%	0.5%	0.0%	0.4%	1.7%	-1.7%	-0.2%	-1.7%	-0.9%
IHOP	-2.7%	-2.9%	-1.5%	-1.0%	-0.5%	-1.4%	-2.0%	-2.6%	-0.5%
Luby's	3.5%	-0.6%	3.5%	2.2%	2.2%	1.1%	2.4%	0.2%	-0.1%
Mean	**0.1%**	**-0.6%**	**0.3%**	**1.0%**	**1.0%**	**0.0%**	**0.3%**	**-0.2%**	**-0.4%**

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

SSS Data (Cont'd)

	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fast Casual:									
Chipotle	12.4%	10.0%	11.3%	11.1%	12.7%	10.2%	4.8%	3.8%	1.0%
Cosi	1.7%	-0.2%	-3.0%	2.6%	7.5%	-0.5%	-0.7%	-3.9%	-4.5%
Einstein Noah Bagel	-0.4%	0.2%	0.7%	1.2%	1.1%	1.3%	0.2%	1.4%	-0.6%
Panera Bread	3.3%	3.9%	4.4%	4.4%	6.3%	5.9%	5.8%	4.9%	3.3%
Qdoba Mexican Grill	6.0%	5.1%	4.3%	3.8%	3.0%	2.1%	3.3%	1.0%	-1.5%
Steak n Shake	4.3%	4.9%	5.3%	5.5%	5.5%	4.8%	2.9%	1.3%	0.3%
Tim Horton's (US)	4.9%	6.4%	6.3%	7.2%	8.5%	4.9%	2.3%	3.2%	-0.5%
Mean	**4.6%**	**4.3%**	**4.2%**	**5.1%**	**6.4%**	**4.1%**	**2.7%**	**1.7%**	**-0.4%**
QSR:									
Chicken:									
KFC	1.0%	-5.0%	-3.0%	-1.0%	2.0%	1.0%	4.0%	4.0%	4.5%
Pollo Tropical	13.5%	10.7%	7.9%	7.8%	9.4%	7.8%	7.0%	8.3%	3.8%
Popeyes	3.9%	0.5%	1.7%	5.9%	8.1%	8.4%	6.8%	6.4%	0.5%
Mean	**6.1%**	**2.1%**	**2.2%**	**4.2%**	**6.5%**	**5.7%**	**5.9%**	**6.2%**	**2.9%**
Coffee/Snack:									
Caribou Coffee	4.3%	4.6%	4.1%	5.6%	2.5%	2.8%	3.5%	-	-
Dunkin Donuts	2.8%	3.2%	6.0%	7.4%	7.2%	4.0%	4.0%	3.2%	1.7%
Jamba Juice	2.2%	4.3%	3.3%	7.7%	12.7%	5.7%	2.5%	0.6%	3.6%
Krispy Kreme	7.0%	2.5%	4.0%	8.3%	2.1%	5.4%	6.8%	7.5%	11.4%
Starbucks	7.0%	8.0%	10.0%	9.0%	8.0%	7.0%	7.0%	7.0%	7.0%
Mean	**4.7%**	**4.5%**	**5.5%**	**7.6%**	**6.5%**	**5.0%**	**4.8%**	**4.6%**	**5.9%**
Mexican:									
Taco Bell	0.0%	-5.0%	-2.0%	-2.0%	6.0%	13.0%	7.0%	5.0%	6.0%
Mean	**0.0%**	**-5.0%**	**-2.0%**	**-2.0%**	**6.0%**	**13.0%**	**7.0%**	**5.0%**	**6.0%**
Pizza:									
Domino's	-1.4%	4.8%	3.0%	6.8%	2.0%	1.7%	3.3%	4.7%	6.2%
Papa John's	6.1%	0.4%	5.3%	1.7%	1.1%	5.7%	2.5%	5.2%	1.6%
Pizza Hut	-3.0%	-2.0%	-3.0%	6.0%	5.0%	4.0%	6.0%	-1.0%	-1.0%
Mean	**0.6%**	**1.1%**	**1.8%**	**4.8%**	**2.7%**	**3.8%**	**3.9%**	**3.0%**	**2.3%**
Sandwich:									
Burger King	-6.0%	-5.3%	-0.3%	-2.0%	4.2%	4.4%	1.6%	3.7%	-3.0%
Carl's Jr.	-0.4%	2.1%	2.0%	2.0%	1.7%	2.6%	5.5%	2.6%	2.9%
Hardee's	5.7%	9.6%	2.5%	1.8%	6.1%	2.6%	3.6%	2.3%	1.1%
Jack in the Box	0.8%	4.7%	5.8%	5.3%	5.6%	3.4%	3.1%	1.9%	0.1%
McDonald's	2.9%	4.5%	4.4%	7.1%	8.9%	3.6%	1.2%	0.3%	-1.2%
Sonic Drive-In	1.2%	3.9%	-0.5%	0.1%	3.5%	2.8%	2.3%	3.0%	1.3%
Wendy's	0.0%	2.3%	0.9%	4.4%	0.7%	3.2%	2.8%	-0.5%	0.7%
Mean	**0.6%**	**3.1%**	**2.1%**	**2.7%**	**4.4%**	**3.2%**	**2.9%**	**1.9%**	**0.3%**
Mean Total QSR	**2.5%**	**2.6%**	**2.7%**	**4.3%**	**5.1%**	**4.7%**	**4.2%**	**3.6%**	**2.6%**

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

Is the Economy Improving or Not?

During the first quarters of the past three years, we have witnessed attempted rebounds in the economy accompanied by robust annual GNP growth projections by the Federal Reserve. Each time, the economy has sputtered by late summer and renewed suspicions of reentering a recession. Increasingly, government statistics, yes even the U.S., are being consistently revised downward as desperate governments have dabbled with excessive cheerleading of their anemic economies. Yet many pundits point to recovering housing prices, mildly improving employment numbers and consistent GDP growth amidst tame inflation as a successful recovery. In addition, low interest rates continue to relieve the economy of the normal burden of financing costs providing that extra edge for personal and business consumption. So which is it? Is the economy recovering or not?

President Truman used to jokingly request one-armed economists because he was sick of hearing the good economic news only to be told that "on the other hand" there are "systemic factors undermining the economy". While I hate to say it, that's the answer. Yes, we have witnessed meaningful improvement in housing prices (due to unsustainably low mortgage rates), and yes, the employment numbers have improved (primarily due to under-employment and headcount rolling off employment), and we have been growing, despite an inflation rate which is much greater than is reported. So the summation is that our improvements are largely either temporary or gerrymandered. Not what we ordered, but we'll take it!

After five years of either stagnant growth or recession, the US consumer is sick and tired of hearing negative financial news, true or not. Moreover, many consumers are starting to add debt again because they are tired of austerity. When you couple this with Ben Bernanke's policies designed to drive everyone into the stock market, you can have what appears to be a pretty good picture: growth in consumption and rising stock prices. We are content with the progress, but very concerned about the false bottoms in some of the data. For instance, if you look at restaurant stock prices it looks like a report card with an "A". However, according to Knapp Track, casual dining restaurant traffic has been negative for 45 of the last 53 months. Category leaders like McDonalds and Darden have voiced concern about restaurant traffic growth in this environment and they are closer to the data than any analyst or economist. In summation, there is probably as much white water ahead of us as behind the boat.

In this environment, restaurant operators should be cautious about the topline, expenses and financing costs. In addition, we believe it is prudent for restaurateurs to look at their estate and liquidity position to see that it matches well with the performance of the economy, their brand and their specific restaurants (especially with respect to franchise agreement expiration, lease expiration, reimaging and loan balance.) We hope for significant improvements in the national financial outlook, however, we think it is prudent not to ignore that many of the statistical gains are on questionable foundations.

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Obamacare Driving Shift to Part-Timers

While foodservice establishments have been adding more jobs than in most other industries in recent months, many of these workers are being hired for part-time positions of less than 30 hours per week. It would appear that this shift to part-timers is at least partly due to the Affordable Care Act (the "ACA"), also referred to as Obamacare. The ACA requires employers with 50 or more full-time employees to offer affordable insurance to employees working 30 or more hours per week or face significant fines.

This part-time hiring emphasis is actually common throughout the U.S. employment base. The Wall Street Journal has reported that in 2013, 81% of the 115,000 average per month number of workers hired, seasonally adjusted, have been part-timers. In 2012, only 15% of the 202,000 per month new workers were part-time. Restaurants and bars, however, are particularly sensitive to increased health care costs as labor expenses already represent 30% or more of sales and it is unclear how much of the new ACA related expenses can be passed on to consumers through higher prices.

Large chains, along with smaller franchisees and operators, are turning to more part-time workers and attempting to reduce some employees' hours to avoid incurring higher health care costs. The actual impact of the ACA remains uncertain. Obama has argued that the ACA will result in lower health care premiums for some companies as smaller businesses will be allowed to pool risks. However, many companies have said the new requirements could increase costs significantly. With annual health insurance premiums running close to $10,000 on average, the all-in cost of hiring full-time employees could grow substantially.

On July 2, 2013, the Obama administration announced a one-year reprieve regarding fines on employers for non-compliance with ACA. The requirements will now become law on January 1, 2015. The reasoning was to enable businesses to adjust to the new provisions with the hope compliance would start to occur in 2014. We do not believe the delayed commencement of the law's mandate will reverse the recent pattern of more foodservice part-timers.

The shift to more part-time workers has several meaningful implications for the restaurant industry. A new paradigm is developing where different nearby restaurants manage their staffing in a coordinated manner to share employees who qualify as part-time workers for two or more restaurants. Operators can thereby hire only new part-time workers and even convert full-time employees to part-time status.

A repercussion of hiring more part-timers in place of full-timers is the potential for reduced productivity form a less skilled workforce and "changeover costs". Just as a when a manufacturer must perform shorter production runs, a restaurant has costs when one shift stops and another starts up. Productivity and service may be impacted negatively.

Another potential impact of an increase in part-timers in the restaurant sector is that the employees may have the sense that companies do not care about their well-being. This could materially influence motivation levels and hurt service. It will make it harder for companies to execute in-store initiatives.

Lastly, some of the lower healthcare benefit costs will be offset by higher administrative expenses associated with managing more workers and closely scrutinizing their hours to ensure they do not go over the 30-hour threshold.

The ACA would appear to be causing restaurant establishments to hire and rely on more part-time employees who will be limited to less than 30 hours per week. While economic impacts of Obamacare remain uncertain, many operators are assuming health care benefits costs/penalties will rise for full-time workers. There are some negative implications of increased part-time employees which will offset some of the benefits. Each restaurant chain must evaluate the trade-offs and implications and decide what employee make-up is right for them.

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