TRINITY CAPITAL
INVESTMENT BANKING

Restaurant Industry Commentary
&
2nd Quarter 2015 SSS

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Same-Store Sales Discussion and Analysis

During the second quarter of 2015 ("Q2 2015"), the restaurant industry maintained positive momentum and now has 21 consecutive quarters of same-store sales growth. Nearly 80.0% of the concepts we cover enjoyed positive same-store sales growth in Q2 2015, with an average year-over-year ("YOY") growth of 3.0% for the restaurant industry. The same-store sales growth is not only meaningful and consistent for the industry on average, but it is also prevalent in each of the five segments within the restaurant industry. That suggests the economy is continuing to improve, the value proposition for many consumers to dine out remains attractive relative to dining in and any declines in same-store sales growth in recent quarters is most likely a result of one or more challenges facing a specific concept. That being said, much of the sales gains in the restaurant industry are a result of price increases, as guest counts remain to be a head-wind for most concepts.

Fine Dining: The fine dining segment saw an average same-store sales increase of 1.1% YOY for Q2 2015. As the chart to the right illustrates, fine dining sales have yet to fully return to pre-recession levels despite 22 consecutive quarters of positive growth. Moreover, the same-store sales increase is lower than aggregate industry price increases during the year.

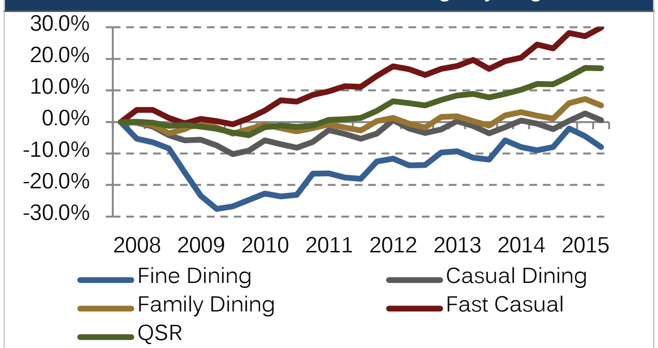
Casual Dining: While the trend in guest counts continues to be a challenge for most casual dining concepts, average same-store sales in the segment improved a modest 1.1% YOY for Q2 2015. According to Knapp-Track, casual dining guest counts were down 1.6%, 1.9% and 1.1% in April, May and June, respectively. That amounts to negative guest counts in 67 of the last 78 months. It is clear that a number of concepts have been increasing menu prices in order to minimize or offset the impact from lower guest counts, but it is difficult to imagine this will be an effective strategy for much longer. With that said, of the 26 concepts we track in the casual dining segment, there are a few concepts that are continuing to outperform, including Buffalo Wild Wings, Dave & Buster's, LongHorn Steakhouse, Outback, Red Robin and Texas Roadhouse.

Family Dining: The family dining segment posted an average YOY same-store sales growth of 3.3% for Q2 2015. Denny's and IHOP led the way with remarkable increases of 7.3% and 6.2%, respectively.

Fast Casual: Each of the 11 concepts we track in the fast casual segment have reported positive same-store sales growth for at least three consecutive quarters. In Q2 2015, the average increase was 4.3% YOY, which is the 23rd consecutive quarter, or nearly six years, of positive comps. We expect both sales and traffic to continue to be strong relative to the rest of the restaurant industry for as long as fast casual concepts remain the favorite among Millenials.

QSR: In the QSR segment, 21 of the 24 concepts we track showed positive same-store sales growth during Q2 2015, with the segment up an average of 4.9% YOY. Within QSR, it is hard not to notice the meteoric growth of Domino's, which posted a 12.8% YOY same-store sales growth in Q2 2015. Alternatively, McDonald's continues to struggle, down 2.0% for the quarter, while the other five QSR sandwich concepts that we track were up an average of 6.2%.

Cumulative Same-Store Sales Change by Segment



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

Overall, this is cautiously encouraging news for the restaurant industry. While an ongoing decline in guest counts, particularly in casual dining, are a concern, the near-term outlook for the industry remains positive.

Contributing Editor Michael Collins is an Associate for Trinity Capital.

Same-Store Sales ("SSS") Data

	FY 2012		FY 2013				FY 2014				FY 2015	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Fine Dining												
Fleming's	10.1%	4.0%	5.4%	2.0%	4.2%	4.9%	1.7%	3.6%	4.8%	3.4%	3.0%	3.2%
Ruth's Chris	5.9%	5.4%	6.6%	4.6%	4.2%	5.5%	2.6%	2.8%	4.8%	5.0%	2.8%	4.2%
Capital Grille	4.0%	2.3%	3.0%	4.5%	3.2%	6.7%	0.1%	0.8%	3.9%	5.0%	6.1%	4.4%
Del Frisco's	5.3%	5.9%	1.9%	5.9%	4.4%	5.2%	5.1%	5.2%	8.4%	4.9%	2.3%	(3.5%)
Sullivan's	1.4%	(1.5%)	(4.0%)	(2.7%)	(5.9%)	(0.7%)	(2.1%)	0.9%	0.6%	1.7%	4.8%	(3.0%)
Mean	**5.3%**	**3.2%**	**2.6%**	**2.9%**	**2.0%**	**4.3%**	**1.5%**	**2.7%**	**4.5%**	**4.0%**	**3.8%**	**1.1%**
Casual Dining												
Applebee's	2.0%	0.9%	(1.3%)	1.3%	(0.4%)	(0.3%)	(0.5%)	0.6%	1.7%	2.8%	2.9%	1.0%
Bahama Breeze	1.2%	1.9%	(0.3%)	(1.7%)	2.7%	6.2%	0.8%	4.1%	N/A	(0.6%)	3.2%	1.8%
BJ's Restaurants	2.3%	3.0%	(0.4%)	0.0%	(2.2%)	(2.7%)	(2.9%)	(1.7%)	0.3%	1.2%	3.2%	0.5%
Bonefish	3.5%	1.0%	0.5%	0.2%	(2.7%)	0.9%	(1.5%)	0.3%	2.6%	0.7%	0.9%	(4.6%)
Bravo! Cucina Italiana	(0.5%)	1.7%	(1.6%)	(1.6%)	(3.7%)	(1.3%)	(5.5%)	(6.0%)	(6.7%)	(3.9%)	(1.7%)	(2.1%)
Brick House Tavern + Tap	N/A	N/A	N/A	N/A	4.0%	6.6%	10.0%	8.5%	7.5%	5.7%	5.4%	2.8%
Brio Tuscan Grille	(1.1%)	(0.5%)	(3.2%)	(4.0%)	(5.1%)	(1.5%)	(4.4%)	(4.5%)	(5.2%)	(4.2%)	(1.0%)	(1.6%)
Buffalo Wild Wings	6.0%	6.7%	1.9%	4.0%	4.3%	4.0%	5.7%	7.0%	5.8%	5.5%	6.5%	3.3%
Carrabba's Italian Grill	1.0%	(0.4%)	(1.7%)	0.3%	0.0%	0.9%	(1.8%)	(1.2%)	(1.2%)	0.3%	1.9%	0.9%
Cheesecake Factory	2.9%	1.3%	1.6%	0.9%	1.0%	1.1%	1.2%	1.5%	2.1%	1.4%	4.2%	2.8%
Chili's Grill & Bar	2.8%	1.0%	(1.1%)	(0.6%)	(1.9%)	0.2%	0.5%	2.5%	2.3%	4.2%	2.2%	0.1%
Chuy's	N/A	N/A	N/A	N/A	3.1%	3.0%	4.2%	2.4%	3.0%	3.8%	1.9%	N/A
Dave & Buster's	5.4%	3.7%	1.8%	(0.9%)	(0.9%)	2.4%	0.7%	4.7%	8.7%	10.5%	9.9%	11.0%
Famous Dave's	0.2%	(6.0%)	(1.8%)	3.8%	(2.3%)	(1.1%)	(3.3%)	(2.8%)	(2.3%)	(4.0%)	(4.9%)	(9.2%)
Granite City	2.5%	4.5%	2.7%	2.5%	0.4%	0.6%	N/A	N/A	0.7%	0.6%	N/A	N/A
Joe's Crab Shack	0.0%	0.0%	(2.0%)	0.7%	3.3%	1.9%	(6.0%)	(4.7%)	(4.4%)	(4.5%)	(3.8%)	(4.0%)
Kona Grill	0.2%	(1.0%)	(2.6%)	2.5%	2.6%	3.5%	6.2%	3.2%	2.7%	3.1%	2.2%	1.0%
Logan's Roadhouse	N/A	N/A	N/A	N/A	(3.9%)	(5.3%)	(3.2%)	(4.5%)	(2.6%)	0.1%	(4.3%)	(4.3%)
LongHorn Steakhouse	2.2%	(0.8%)	(1.6%)	3.5%	3.2%	2.9%	0.3%	2.4%	2.8%	2.6%	5.4%	5.2%
Maggiano's	0.9%	0.6%	0.4%	0.2%	0.6%	0.9%	0.2%	0.9%	0.6%	2.3%	0.1%	(0.1%)
Olive Garden	0.3%	(3.2%)	(4.1%)	1.1%	(4.0%)	(0.6%)	(5.4%)	(4.2%)	(1.3%)	2.2%	2.2%	3.4%
Outback	4.5%	5.3%	2.5%	2.8%	(0.3%)	1.1%	0.8%	0.9%	4.8%	6.4%	5.0%	4.0%
Red Robin	0.6%	1.4%	1.4%	3.6%	5.4%	3.7%	5.8%	1.6%	1.4%	4.3%	3.8%	3.6%
Ruby Tuesday	1.9%	0.3%	(2.8%)	(3.1%)	(11.4%)	(7.8%)	(1.9%)	0.4%	1.1%	(1.0%)	(0.3%)	(1.7%)
Taco Cabana	1.8%	6.8%	2.0%	1.1%	1.8%	(2.9%)	0.8%	2.8%	3.5%	6.1%	3.8%	5.6%
Texas Roadhouse	3.9%	4.5%	3.7%	4.7%	2.9%	2.5%	3.0%	3.0%	5.8%	6.8%	8.7%	8.0%
Mean	**1.9%**	**1.4%**	**(0.3%)**	**0.9%**	**(0.1%)**	**0.7%**	**0.2%**	**0.7%**	**1.3%**	**2.0%**	**2.3%**	**1.1%**
Family Dining												
Bob Evans	1.0%	1.6%	0.0%	(0.6%)	(1.9%)	(1.8%)	(4.1%)	(2.0%)	0.0%	3.8%	2.1%	(0.3%)
Chuck E Cheese	N/A	N/A	N/A	N/A	(2.1%)	N/A	N/A	N/A	N/A	(1.4%)	(5.0%)	3.0%
Cracker Barrel	N/A	3.3%	3.1%	3.1%	2.8%	(0.6%)	(0.7%)	1.3%	3.3%	7.9%	5.2%	3.8%
Denny's	0.4%	1.7%	(0.7%)	0.6%	1.2%	0.9%	1.8%	1.9%	2.4%	4.7%	7.2%	7.3%
IHOP	(2.0%)	(2.6%)	(0.5%)	1.9%	3.6%	4.5%	3.9%	3.2%	2.4%	6.1%	4.8%	6.2%
Luby's	2.4%	0.2%	(0.1%)	(0.1%)	1.0%	2.4%	1.2%	2.0%	0.4%	0.2%	3.1%	(1.0%)
Peter Piper Pizza	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3.4%	6.8%	5.3%
Pizza Inn	N/A	N/A	N/A	N/A	(3.5%)	(4.1%)	4.4%	N/A	4.6%	6.4%	6.0%	0.2%
Steak n Shake	2.9%	3.8%	1.3%	0.3%	4.2%	2.2%	3.0%	3.7%	2.6%	2.9%	6.0%	4.8%
Mean	**0.9%**	**1.3%**	**0.5%**	**0.9%**	**0.7%**	**0.5%**	**1.4%**	**1.7%**	**2.2%**	**3.8%**	**4.0%**	**3.3%**

SSS Data (Cont'd)

	FY 2012		FY 2013				FY 2014				FY 2015	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Fast Casual												
Chipotle	4.8%	3.8%	1.0%	5.5%	6.2%	9.3%	13.4%	17.3%	19.8%	16.1%	10.4%	4.3%
Cosi	(0.7%)	(3.9%)	(4.5%)	(2.7%)	(3.6%)	(4.6%)	(9.5%)	(4.7%)	(1.9%)	4.2%	4.4%	2.1%
El Pollo Loco	N/A	N/A	N/A	N/A	3.7%	6.5%	7.2%	5.5%	7.9%	7.6%	3.5%	1.3%
Fuddrucker's	N/A	N/A	N/A	N/A	(0.4%)	(2.3%)	(2.7%)	(3.9%)	(4.6%)	0.2%	2.1%	0.2%
Noodles & Company	3.4%	4.2%	2.2%	4.7%	2.1%	3.9%	(1.6%)	0.2%	1.7%	1.3%	0.9%	0.1%
Panera Bread	5.8%	4.9%	3.3%	3.7%	1.3%	1.1%	0.1%	0.1%	1.4%	3.0%	0.7%	1.8%
Pie Five	N/A	N/A	N/A	N/A	N/A	N/A	4.4%	12.9%	17.0%	16.9%	9.5%	6.7%
Potbelly	N/A	N/A	N/A	N/A	2.5%	0.7%	(2.2%)	(1.6%)	0.5%	3.7%	5.4%	4.9%
Qdoba Mexican Grill	3.3%	1.0%	(1.5%)	1.3%	2.0%	2.3%	7.0%	7.5%	7.7%	14.0%	8.3%	7.7%
Shake Shack	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	7.2%	11.7%	12.9%
Zoe's Kitchen	N/A	N/A	N/A	N/A	N/A	N/A	5.7%	7.5%	5.9%	7.8%	N/A	5.6%
Mean	**3.3%**	**2.0%**	**0.1%**	**2.5%**	**1.7%**	**2.1%**	**2.2%**	**4.1%**	**5.5%**	**7.5%**	**5.7%**	**4.3%**
QSR												
Chicken												
Bojangles	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.2%	5.3%	7.0%	7.9%	4.4%
Church's	N/A	(1.3%)	(2.0%)	1.8%	1.2%	0.9%	(0.7%)	0.3%	1.7%	3.6%	2.8%	(2.6%)
KFC	4.0%	4.0%	4.5%	3.0%	(4.0%)	(5.0%)	(3.0%)	(2.0%)	2.0%	6.0%	7.0%	3.0%
Pollo Tropical	7.0%	8.3%	3.8%	6.4%	6.5%	7.0%	6.3%	6.7%	5.9%	7.7%	6.4%	4.3%
Popeye's	6.8%	6.4%	0.5%	4.3%	5.1%	0.3%	4.3%	3.8%	7.2%	10.7%	7.0%	7.9%
Mean	**5.9%**	**4.4%**	**1.7%**	**3.9%**	**2.2%**	**0.8%**	**1.7%**	**2.6%**	**4.4%**	**7.0%**	**6.2%**	**3.4%**
Coffee/Snack												
Baskin Robbins	1.1%	1.5%	(4.4%)	1.6%	4.2%	2.2%	0.5%	4.2%	5.8%	9.3%	8.0%	3.4%
Dunkin Donuts	4.0%	3.2%	1.7%	4.0%	4.2%	3.5%	1.2%	1.8%	2.0%	1.4%	2.7%	2.9%
Jamba Juice	2.5%	0.6%	1.3%	1.7%	(3.4%)	0.3%	0.6%	2.5%	3.7%	4.9%	5.0%	(5.9%)
Krispy Kreme	6.8%	7.5%	11.4%	10.0%	3.7%	1.6%	3.3%	2.3%	3.7%	3.6%	5.2%	5.5%
Starbucks	7.0%	7.0%	7.0%	9.0%	8.0%	5.0%	6.0%	6.0%	5.0%	5.0%	7.0%	8.0%
Tim Horton's	2.3%	3.2%	(0.5%)	1.4%	3.0%	3.1%	1.9%	5.9%	6.8%	4.1%	8.9%	7.0%
Mean	**4.0%**	**3.8%**	**2.8%**	**4.6%**	**3.3%**	**2.6%**	**2.3%**	**3.8%**	**4.5%**	**4.7%**	**6.1%**	**3.5%**
Mexican												
Del Taco	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	7.7%	6.0%
Taco Bell	7.0%	5.0%	6.0%	2.0%	2.0%	1.0%	(1.0%)	2.0%	3.0%	7.0%	6.0%	6.0%
Mean	**7.0%**	**5.0%**	**6.0%**	**2.0%**	**2.0%**	**1.0%**	**(1.0%)**	**2.0%**	**3.0%**	**7.0%**	**6.9%**	**6.0%**
Pizza												
Domino's	3.3%	4.7%	6.2%	6.7%	5.4%	3.7%	4.9%	5.4%	7.7%	11.1%	14.5%	12.8%
Papa John's	2.5%	5.2%	1.6%	3.4%	1.8%	6.6%	9.6%	6.0%	7.4%	4.1%	6.5%	5.5%
Papa Murphy's	N/A	N/A	N/A	N/A	3.0%	4.0%	3.3%	1.5%	1.5%	N/A	5.6%	4.5%
Pizza Hut	6.0%	(1.0%)	(1.0%)	(2.0%)	(1.0%)	(4.0%)	(5.0%)	(4.0%)	(2.0%)	0.0%	(1.0%)	1.0%
Mean	**3.9%**	**3.0%**	**2.3%**	**2.7%**	**2.3%**	**2.6%**	**3.2%**	**2.2%**	**3.7%**	**5.1%**	**6.4%**	**6.0%**
Sandwich												
Arby's	N/A	N/A	N/A	N/A	N/A	N/A	N/A	6.3%	10.4%	4.9%	9.7%	7.6%
Burger King	1.6%	3.7%	(3.0%)	(0.5%)	(0.3%)	0.2%	0.1%	0.4%	3.6%	4.2%	6.9%	7.9%
Jack in the Box	3.1%	1.9%	0.1%	0.1%	(1.4%)	1.9%	0.7%	2.4%	3.1%	4.4%	8.9%	7.3%
McDonald's	1.2%	0.3%	(1.2%)	1.0%	0.7%	(1.4%)	(1.7%)	(1.5%)	(3.3%)	(1.7%)	(2.6%)	(2.0%)
Sonic Drive-In	2.3%	3.0%	1.3%	0.1%	5.9%	2.2%	1.4%	5.3%	3.5%	8.5%	11.5%	6.1%
Wendy's	2.8%	(0.5%)	0.7%	0.3%	3.1%	2.9%	0.7%	3.2%	0.8%	1.7%	3.2%	2.2%
Mean	**2.2%**	**1.7%**	**(0.4%)**	**0.2%**	**1.6%**	**1.2%**	**0.2%**	**2.7%**	**3.0%**	**3.7%**	**6.3%**	**4.9%**
Mean Total QSR	**4.0%**	**3.3%**	**1.8%**	**2.9%**	**2.4%**	**1.8%**	**1.7%**	**2.9%**	**3.9%**	**5.1%**	**6.3%**	**4.5%**

The Perfect Employee

I was talking to a restaurant executive recently and he told me that he had found the perfect employee. He said the employee was never late or sick and never complained, messed up an order, took vacation, asked for a raise or fought with other employees. I asked him who was this employee and he replied, "His name is Kiosk."

Automated kiosks are not a new concept to the restaurant industry. I remember seeing them in a McDonald's in Budapest in 1995. The kiosk had a crude video screen that would query what you wanted to order and then you would pay for the items with a credit card or you could even feed paper currency into the machine. Today, technology has improved by leaps and bounds and the human interface available from industry-leading kiosk manufacturers is amazing and makes these devices very profitable. Companies such as Nextep Systems and SeePoint have developed outstanding point-of-sale kiosks that provide customer interaction, ordering and payment functions for restaurants. There are number of factors driving this development and chief among them is the monumental increase in wages caused by minimum-wage legislation in many jurisdictions around the country.

Communities such as New York, Los Angeles, Seattle, Berkeley and many others across the nation have adopted wage legislation that significantly increases the present and future minimum-wage requirements for establishments with requisite numbers of employees and sales. Some industry and press pundits have mistakenly surfaced the notion that 50% and 100% increases in crew level wages can be passed onto the consumer. This could not be farther from the truth. Five of the top 10 QSR chains right now are engaged in studying their value menu and making changes to bundling offerings that will bring check averages down. This is in response to a tepid economy both globally and at home. The notion that significant increases in minimum wage will somehow generate more traffic in local area QSR establishments as a meaningful offset to higher labor costs is a fallacy. QSR traffic is heavily correlated with price, offering, location, advertising, promotion and motor fuel prices, but not prevailing local minimum wages.

One of the unintended consequences of advancing minimum wages is that the whole cost structure of the restaurant must undergo a significant shift to accommodate sizeable increases in crew wages. Consider that when prevailing minimum wage is $7.50 and the local jurisdiction enacts legislation to increase it by $2.00 a year for four consecutive years, there are many other costs associated with this legislation, in addition to direct crew labor. Social Security, workers compensation, unemployment insurance and payroll taxes dramatically increase when double-digit minimum-wage percentage increases become effective. In addition, shift leaders, night and assistant managers and restaurant general managers all require significant wage increases to maintain parity with the prevailing minimum wage paid to crews. Without offsetting price increases, this kind of wage inflation can quickly erode a restaurants ability to produce consistent positive cash flow. QSR executives will be almost unanimous in seconding the notion that dramatic minimum-wage increases in the 50% to 100% range are not anywhere near fully recoverable through menu price increases. Consequently, significant losses can occur very quickly in those QSR establishments that are unable to pass on dramatic wage, payroll and associated cost increases.

The nation's restaurant industry has long been a fertile training ground for minimum-wage employees. Restaurants provide more jobs than any other industry (except government) and the job market is very efficient because entry-level wages are typically not a burden for entrepreneurs. Most minimum-wage employees are students and Millennials who do not plan on staying at the job very long (the average QSR crew-level length of employment is approximately 90 days) and are by no means head of household or looking for a "living wage". The Department of Labor conducted a study and found that minimum-wage employees earned $1.40 per hour more by remaining in the same job for one year. Good employers tend to pay a little more than minimum wage, but more importantly, they rapidly promote individuals that exhibit the character, drive and job skills requisite for moving into a role of increasing responsibility.

I was recently interviewed by a national publication at the university where I teach. They asked me what I would do about a 35-year-old head of household with two children and a wife to support working in the QSR industry at $7.50 an hour. Without hesitating I replied that in the 17 years since graduating high school (assuming this individual is not a convicted felon) this employee apparently failed to generate any more job skills that a 16-year-old high school student would have in his or her first job. This is failure to accumulate appreciable skills in the marketplace. Legislating to reward market place ineptitude will breed more of the same. Generally, what you subsidize you get more of, and what you penalize you get less of. Expensive traffic tickets really discourage speeding.

Most of the large restaurant chains around the country are thoroughly investigating ways in which kiosks can provide value in their restaurants through cost reduction, upselling, speed of service, order accuracy, convenience and location. It seems that the intensity of this technological shift has been exacerbated by the continuous drumbeat of minimum-wage legislation sweeping through the nation's large cities. State and local governments must carefully consider what they will achieve by pushing this agenda. I firmly believe that the full costs of glacial minimum-wage increases are not well understood by the marketplace or politicians that have surfaced these bills. In the medium and long-run, businesses move rapidly to environments that produce greater profits. Everybody remembers what happened to the industries targeted by organized labor in the 1960s and 1970s…their business went to Japan. That would include manufacturers of cameras, stereo systems, consumer electronics, radios, televisions, tool and die parts and steel.

Kiosks provide tremendous benefits in addition to a static hourly cost, which are highly attractive for retail establishments struggling to deal with wages that have recently become a higher percentage of revenues than they have been historically. We believe that the modest incursions of kiosks into the QSR industry thus far will change dramatically in the years to come as the cost and benefits of these devices becomes starkly more profitable than hourly wage employees. Unfortunately, there is a human cost, which thus far seems to have eluded the discussions.

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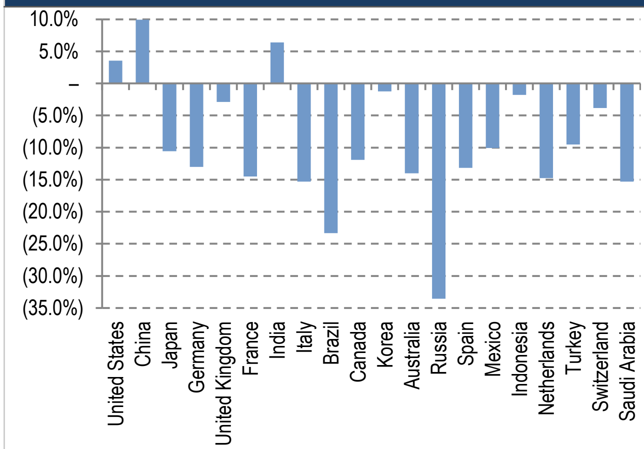
Special Report

There is a lot of economic, military and political activity in the world right now that we believe will begin to impact the restaurant industry in a meaningful way in 2016 and beyond. Already, most of the top 20 global economies are now at or near recession levels of economic activity. There are many causes to this, including the China slowdown, military activity in the Middle East and tepid economic activity in Western democracies.

Top 20 GDP Countries: YTD 2015 GDP % Change YOY



Source: IMF World Economic Outlook, October 2015

Federal Reserve Chairwoman, Janet Yellen, recently told an audience at the University of Massachusetts that she wanted to raise interest rates, ostensibly to tame prices and avoid unacceptably high levels of inflation. The reality is that she is gravely concerned about valuation bubbles that are quietly appearing again in the stock market and bond markets, residential housing, commercial real estate and student loans. It is much more efficient to let air out of these bubbles slowly than to stand by and watch them burst as they did in 2008, which ultimately caused hundreds of billions of dollars of losses throughout the financial spectrum. However, politicians and foreign central bankers prevailed against Yellen's decision to raise rates at the recent FOMC meeting. Politicians voiced concern over the sluggish economic recovery we are in and how volatile the stock market has been recently as a referendum on anemic broader economic activity. Foreign central bankers, citing negative GDP growth, the prospect of a significant increase in commodity prices and interest cost on dollar-denominated debt, simply pleaded with Yellen for mercy not to push them further into recession. They pointed out their recession could eventually harm the U.S. economy as well.

So for now it looks like we should not expect an interest rate increase from the Federal Reserve through the end of the year, which on the face of it would seem like good news. However, the bubbles persist and some asset classes could see a selloff if there is a catalytic event that catches the eye of the financial markets. One of the biggest risks we face right now in the financial markets has nothing to do with economic fundamentals whatsoever. We strongly believe the biggest risk facing the markets today is geopolitical uncertainty stemming from terrorism, military conflict in the Middle East and potential bad behavior from North Korea, Russia or China. These countries have been bad actors for a long time and it is worth noting that they do not believe the U.S. will discipline them, so they continue to misbehave.

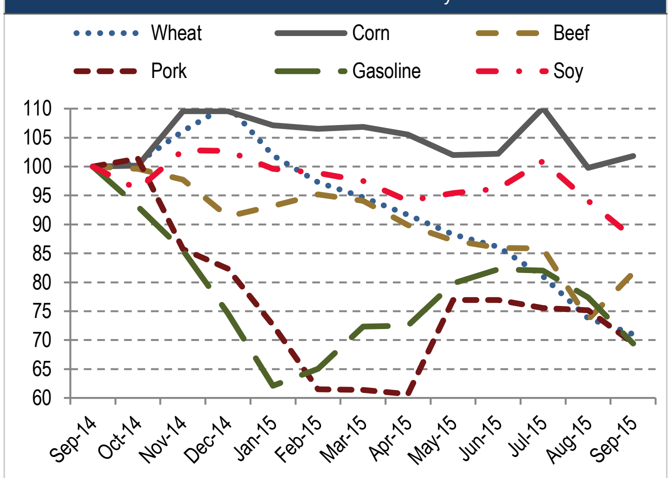
The Russians recently gobbled up Crimea, which was Russian territory given to the Ukraine people in the 1950s to mollify them after anti-Soviet uprisings in the Eastern Bloc. Vladimir Putin decided that he needed the Crimean port strategically. He wanted the oil facilities, and rather than have a referendum, which he probably would have won, he simply took it like a bully. What was the response from the U.S.? Nothing. As a result, Putin is now providing weapons to Iran to be used against Yemen in a proxy war versus Saudi Arabia. He has also moved troops, aircraft and missiles into Syria and is running a proxy war against the U.S. in that country as well. It was recently revealed that metallurgical findings from the remnants of flight MH 170 positively identified Russian rocket propellant used in surface-to-air missiles. What will happen next?

What does this have to do with the restaurant industry? We strongly believe that the Russians are trying to start a war in the Middle East, because this will cause international insurance companies to revoke insurance protection on oil assets, particularly tankers in the Persian Gulf. This effectively cuts off approximate 40% of world oil supply and will cause oil prices shoot up above $200 per barrel. This means $10 per gallon gasoline in the U.S., which will substantially reduce transaction count in the restaurant industry. The Russians need this because their economy is flailing with the world sanctions imposed as a result of their invasion of Crimea and questionable behavior in Ukraine. Not a very cheerful bit of news, but a very true set of facts.

China's economy is beginning to unravel because they have not been able to institute the transparency, accountability and ethical standards necessary for a free market economy to thrive. Many Chinese companies cannot stand a Western-style accounting audit and the Chinese Communist Party tends to obfuscate bad news and accentuate anything positive in their economy. The Chinese stock market is significantly overvalued and local investors have been quietly withdrawing money for some time now. The government has propped this market up with billions of dollars to no avail, as the market is down over 30% from its peak in June of this year. In addition, the Chinese banking system is beholden to its industrial base and the Chinese Communist Party. The banks are severely undercapitalized compared to Western institutions, particularly U.S. banks, and counterparty risk is starting to become an issue with many foreign financial institutions. Finally, the Chinese real estate market has glacial levels of vacancy and nonperforming assets. This trifecta of financial burdens is not sustainable by the Chinese economy. Consequently, like the Russians, the Chinese are starting to misbehave in many areas including with the internet, with espionage, by building militarized artificial islands in international territory and violating U.S. territorial waters in the Aleutian Islands. All of this represents government efforts to distract the Chinese working class citizens who are otherwise very concerned due to the broad economic slowdown.

The restaurant industry has enjoyed one of its best commodity years in the last two decades. Aside from chicken, almost every other protein, vegetable, grain and hydrocarbon has fallen anywhere from modestly to as much as 40% this year.

Indexed Historical Commodity Prices



Source: EIA, Index Mundi

Commodity prices are falling because there has been a substantial and consistent reduction in demand around the world. International markets have been building supply in principal commodities as forecasters consistently overestimate consumption. Most notably, Canada and Australia are currently experiencing a recession because they are significant commodity producers and their exports have dropped off dramatically. Their largest client is China, who just declared GDP growth of 6.9% for the most recent quarter, the slowest in 10 years. In all likelihood, the Chinese growth is flat and the government numbers are not correct. The good news is that U.S. restaurants are experiencing a banner year due to the attractive price of commodities and motor fuels. The challenging news is that the ultimate contagion from slow growth or no growth economies will eventually affect U.S. economic activity. At that point in time, we should expect a more precipitous decline in overall restaurant traffic. The bright shining star in all of this is that even in more difficult economic times, the behavior trends and demographics of the U.S. strongly favor increased restaurant traffic in spite of the pressures to economize. Grocery stores are desperately trying to increase the variety and accessibility of ready-made food offerings, which poses some competition to the restaurant industry. All that being said, we expect lower transaction count in the restaurant industry next year as a whole, but there is potential for traffic gains among concepts that are focused on Millennials or have cult-type customer following.

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