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Same-Store Sales Discussion and Analysis

The second quarter of 2012 maintained the positive momentum in same-store sales, which is impressive as we continue to comp over positive results from the prior year. Bolstered by improving sales and traffic results, the restaurant industry reported its ninth consecutive quarter of same store sales gains. It should be noted however, that traffic has slowed or declined within many prominent chains.

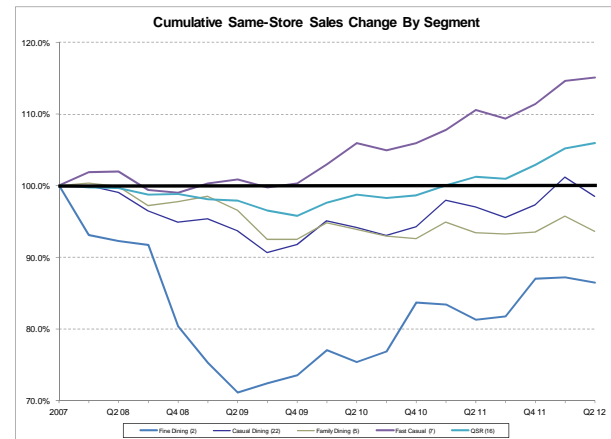
In fine dining, the companies we track were up from 2011 by an average of 6.4% for the second quarter of 2012. It is important to note that fine dining sales continue to be well below pre-recession levels as these positive percentage increases are much lower than the dramatic percentage declines the segment experienced during 2009 and the first quarter of 2010. Nonetheless, these gains represent real momentum given last year's positive results.

In casual dining, the concepts we follow were up by an average of 1.5% for the second quarter of 2012. This is the ninth 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 1.9% in April, down by 3.9% in May and down by 1.2% in June. The family dining concepts we track reported an average increase in same-store sales of 0.2% during the second quarter of 2012.

The fast casual segment reported positive same-store sales performance for a twelfth consecutive quarter. The segment was positive by 4.1% for the first quarter of 2012. The positive comps in the fast casual segment are more impressive than the other

segments because they continue to comp over positive results and show no sign of slowing down.

In the QSR segment, all 19 concepts we track were positive during the second quarter of 2012 while the segment was up by an average of 4.7%. Taco Bell had a very strong quarter, up by 13.0%. The large increase in second quarter sales was primarily driven by the extremely successful launch of the Doritos Locos Tacos product.



According to the National Restaurant Association, a majority of restaurant operators expect their sales to be higher in the coming months. However, we are concerned about the slowdown in traffic in the casual dining segment. Casual and fine dining chains are usually the first to feel the effects of an economic slowdown as consumers start to tighten their budgetary belts and start trading down. However, even McDonalds rolled out their Monopoly promotion in the third quarter to bolster sluggish sales. The company typically saves this extremely effective campaign for those quarters where they feel a sales boost is needed.

Therefore, we recommend that all restaurant operators remain focused on keeping costs down and conserving cash in case the slowdown in traffic continues and same-store sales start to level off or even decline.

Contributing Editor Joshua L. Brannan is a Vice President for Trinity Capital.

Same-Store Sales ("SSS") Data

	<u>Q3 10</u>	<u>Q4 10</u>	<u>Q1 11</u>	<u>Q2 11</u>	<u>Q3 11</u>	<u>Q4 11</u>	<u>Q1 12</u>	<u>Q2 12</u>
Fine Dining:								
Fleming's	7.3%	18.4%	11.4%	9.9%	10.1%	0.3%	5.4%	6.8%
Ruth's Chris	4.9%	9.2%	5.2%	5.8%	2.6%	7.7%	3.7%	6.0%
Mean	6.1%	13.8%	8.3%	7.9%	6.4%	4.0%	4.6%	6.4%

Casual Dining:

Applebee's	3.3%	2.9%	3.9%	3.1%	-0.3%	1.0%	1.2%	0.4%
Benihana	4.7%	4.4%	5.6%	6.0%	6.4%	7.0%	4.8%	4.5%
BJ's Restaurants	6.7%	5.9%	7.8%	6.9%	6.5%	5.1%	3.3%	4.4%
Bonefish	7.8%	9.3%	9.6%	10.2%	7.4%	5.9%	6.2%	2.1%
Buffalo Wild Wings	1.1%	-0.8%	2.4%	3.9%	4.8%	7.1%	8.1%	5.4%
Carrabba's Italian Grill	4.9%	5.4%	3.9%	4.8%	6.3%	3.5%	4.3%	1.5%
CEC Entertainment	3.8%	3.9%	1.1%	-2.0%	-6.3%	-3.6%	-4.2%	-2.4%
Cheesecake Factory	2.9%	1.0%	2.1%	2.3%	0.8%	2.7%	2.6%	2.1%
Chili's Grill & Bar	-5.0%	-4.9%	-3.0%	2.1%	1.7%	1.4%	4.6%	2.2%
Dave & Buster's	-1.3%	1.2%	5.3%	1.9%	2.7%	-0.9%	-0.3%	5.4%
Famous Dave's	2.4%	3.3%	3.0%	-1.2%	-0.1%	3.6%	-1.6%	-0.6%
Frisch's Golden Corral ¹	4.4%	1.4%	-0.9%	-3.6%	-4.9%	7.8%	12.4%	0.0%
Granite City	4.0%	3.6%	3.8%	3.5%	3.0%	4.0%	1.9%	1.5%
LongHorn Steakhouse	6.8%	4.5%	6.1%	6.0%	4.8%	6.7%	3.8%	3.0%
Maggiano's	1.4%	4.7%	3.4%	5.7%	3.5%	2.8%	3.9%	1.9%
Olive Garden	2.0%	2.0%	0.0%	0.0%	-2.9%	-2.5%	2.0%	-1.8%
Outback	3.0%	2.5%	4.3%	1.8%	6.0%	3.6%	5.3%	2.3%
Red Lobster	-1.6%	-1.6%	0.1%	3.8%	10.7%	6.8%	6.0%	-3.9%
Red Robin	1.7%	1.6%	2.1%	2.9%	2.1%	4.5%	1.0%	1.2%
Ruby Tuesday	1.2%	4.2%	-1.2%	-0.1%	-4.1%	-4.2%	-5.0%	-4.6%
Taco Cabana	1.0%	2.3%	2.0%	4.5%	5.3%	2.7%	6.1%	4.5%
Texas Roadhouse	4.3%	3.1%	4.5%	4.3%	3.9%	5.6%	6.2%	4.6%
Mean	2.7%	2.7%	3.0%	3.0%	2.6%	3.2%	3.3%	1.5%

Family Dining:

Bob Evans	-0.9%	-0.5%	1.2%	-1.8%	-1.5%	1.6%	-0.6%	1.0%
Denny's	-1.1%	-1.4%	-1.7%	2.0%	0.9%	1.6%	2.4%	0.8%
Frisch's Big Boy	-0.8%	-1.1%	0.2%	0.5%	0.0%	0.4%	1.7%	-1.7%
IHOP	0.1%	1.1%	-2.7%	-2.9%	-1.5%	-1.0%	-0.5%	-1.4%
Luby's	5.5%	2.7%	3.5%	-0.6%	3.5%	2.2%	1.1%	2.2%
Mean	0.6%	0.2%	0.1%	-0.6%	0.3%	1.0%	0.8%	0.2%

¹ Frisch's is a Golden Corral franchisee that operates 35 restaurants

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

SSS Data (Cont'd)

	<u>Q3 10</u>	<u>Q4 10</u>	<u>Q1 11</u>	<u>Q2 11</u>	<u>Q3 11</u>	<u>Q4 11</u>	<u>Q1 12</u>	<u>Q2 12</u>
Fast Casual:								
Chipotle	11.4%	12.6%	12.4%	10.0%	11.3%	11.1%	12.7%	10.2%
Cos i	5.2%	4.5%	1.7%	-0.2%	-3.0%	2.6%	7.5%	-0.5%
E instein Noah Bagel	0.7%	1.6%	-0.4%	0.2%	0.7%	1.2%	1.1%	1.3%
P anera Bread	6.9%	5.8%	3.3%	3.9%	4.4%	4.4%	6.3%	5.9%
Qdoba Mexican Grill	5.6%	6.4%	6.0%	5.1%	4.3%	3.8%	3.0%	2.1%
Steak n Shake	3.0%	2.1%	4.3%	4.9%	5.3%	5.5%	5.5%	4.8%
Tim Horton's (US)	3.3%	6.3%	4.9%	6.4%	6.3%	7.2%	8.5%	4.9%
Mean	5.2%	5.6%	4.6%	4.3%	4.2%	5.1%	6.4%	4.1%

QSR:

Chicken:

KFC	-8.0%	1.0%	1.0%	-5.0%	-3.0%	-1.0%	2.0%	1.0%
P ollo Tropical	8.8%	10.7%	13.5%	10.7%	7.9%	7.8%	9.4%	7.8%
P opeyes	5.3%	6.2%	3.9%	0.5%	1.7%	5.9%	8.1%	8.4%
Mean	2.0%	6.0%	6.1%	2.1%	2.2%	4.2%	6.5%	5.7%

Coffee/Snack:

Caribou Coffee	4.4%	3.5%	4.3%	4.6%	4.1%	5.6%	2.5%	2.8%
Dunkin Donuts ²	2.7%	4.7%	2.8%	3.2%	6.0%	7.4%	7.2%	4.0%
Jam ba Juice	-2.7%	0.2%	2.2%	4.3%	3.3%	7.7%	12.7%	5.7%
Kris py Kreme	5.0%	1.1%	7.0%	2.5%	4.0%	8.3%	2.1%	5.4%
Starbucks	8.0%	8.0%	7.0%	8.0%	10.0%	9.0%	8.0%	7.0%
Mean	3.5%	3.5%	4.7%	4.5%	5.5%	7.6%	6.5%	5.0%

Mexican:

Taco Bell	3.0%	4.0%	0.0%	-5.0%	-2.0%	-2.0%	6.0%	13.0%
Mean	3.0%	4.0%	0.0%	-5.0%	-2.0%	-2.0%	6.0%	13.0%

Pizza:

Domino's	11.7%	6.3%	-1.4%	4.8%	3.0%	6.8%	2.0%	1.7%
P apa John's	-0.6%	0.7%	6.1%	0.4%	5.3%	1.7%	1.1%	5.7%
P izza Hut	8.0%	10.0%	-3.0%	-2.0%	-3.0%	6.0%	5.0%	4.0%
Mean	6.4%	5.7%	0.6%	1.1%	1.8%	4.8%	2.7%	3.8%

Sandwich:

Burger King	-4.2%	-5.8%	-6.0%	-5.3%	-0.3%	-2.0%	4.2%	4.4%
Carl's Jr.	-7.4%	-5.0%	-0.4%	2.1%	2.0%	2.0%	1.7%	2.6%
Hardee's	6.8%	8.3%	5.7%	9.6%	2.5%	1.8%	6.1%	2.6%
Jack in the Box	-4.0%	1.5%	0.8%	4.7%	5.8%	5.3%	5.6%	3.4%
McDonald's	5.3%	4.4%	2.9%	4.5%	4.4%	7.1%	8.9%	3.6%
Sonic Drive-In	-6.4%	-2.4%	1.2%	3.9%	-0.5%	0.1%	3.5%	2.8%
Wendy's	-1.7%	0.2%	0.0%	2.3%	0.9%	4.4%	0.7%	3.2%
Mean	-1.7%	0.2%	0.6%	3.1%	2.1%	2.7%	4.4%	3.2%

Mean Total QSR	1.8%	3.0%	2.5%	2.6%	2.7%	4.3%	5.1%	4.7%
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* Source: Restaurant Research LLC, Capital IQ and company filings

² Dunkin Donuts did not report quarterly same store sales prior to Q1 2010.

Business Intelligence Software is Driving Restaurant Profits

An important tool is emerging as an undisputed victor from the ashes of the 2008 recession, the subsequent dramatic rise in commodity prices, and other escalations in restaurant operating costs. Sophisticated restaurant operators are beginning to use business intelligence software ("BI") to manage increasingly volatile P&L statements where utilities, insurance, food costs, paper costs, labor and other line items have lost their traditional predictability. Some of the leading restaurant business intelligence software packages, such as those provided by, Delaget, Xformity and InfoSync, (there are others developed by franchisees and franchisors) allow restaurant managers to use data in order to plan and control operations with more precision. They are also afforded a finer look at data which allows them to identify and eliminate waste. We have noticed significant economic benefits among operators who use these tools to track, evaluate and improve their performance.

Once a restaurant operator has implemented a BI system, one of the first things they will notice is the variance in performance of individual stores. These software tools help to identify not only specific store level variances, but also the portion of the cost which is explainable versus that which is not. For example, if a KFC district manager is reviewing his or her stores, there very well may be a store that features a buffet serving format. The store will undoubtedly have a higher food cost due to historical norms of this serving format. This is considered an explainable variance from the company's average food cost. However, if the number is too high there will be unexplainable components in the food cost which will be underscored by the use of business intelligence software. Generally, unexplainable variances are due to human behavior which can usually be corrected and mitigated. This allows for more consistency in management and ultimately higher profitability.

Employee cost is a key line item in which business intelligence software has been able to provide value to its users. Fingerprint scanners can be directly connected to a manager's PC and give real-time reporting on employee start and end times for their shift, breaks and meals. Business intelligence software can also be used to notify managers when people need breaks or if they are about to exceed overtime according to local law.

Another very valuable labor saving potential of the BI software is to comprehensively analyze labor scheduling for restaurant operators. These sophisticated planning tools take into consideration prevailing and historical weather, current and former advertising modules, movable holidays, recent volume, current LTO and POP as well as recent shift labor averages. This comprehensive forecasting tool vastly improves labor efficiencies over traditional methodologies used in the industry.

Historically, restaurants had very generous store operating profits and were slower to embrace technology beyond point of sale devices. Restaurateurs' slow adoption of these technologies comes in sharp contrast to other industries which featured leaner profitability and necessarily more sophisticated systems and cost controls. However, increased restaurant development, rising costs and intensified competition have eroded restaurant operating profits and increased business risk. This has given rise to a dramatic increase in the popularity of BI software throughout the industry. Restaurant operators have come to realize that the BI software pays for itself through lower costs and more improved operations and customer service. Franchisor executives are quick to point out to us that the advent of this development has remarkably impacted the performance of those franchisees which have embraced it. BI pays for itself.

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Grain Pricing Update & Protein Cycle Impact

Droughts, global pork shortages and Super Bowl chicken wings... protein pricing is a primary preoccupation within the restaurant industry today.

Most analysts predict that the supply of grain will grow at a slower pace than the forecast acceleration of mouths to feed and cars to operate. Grain is the primary driver of the price of meat over time and generally serves as a lead indicator for the pricing for produce. In fact, higher priced food is a long term trend that Trinity has continually referenced in our commentary. But the following commentary has to do with the next 2-3 years of protein pricing as impacted by the recent drought and the corresponding spike in grain prices.

The Friday (Sept. 28, 2012) ag-report surprised traders once again as U.S. corn and wheat stockpiles shrank far more this summer than expected. As a result, prices surged 6% and 5%, respectively. Wheat futures briefly topped \$9 a bushel, and corn prices have hovered at their all time highs, teasing \$8 a bushel through the summer.

Corn stockpiles were below 1 billion bushels for the first time in eight years, and general grain reserves were between 10% and 15% lighter than expectations. With grain stocks falling to shockingly low levels, some analysts are now predicting sustained peak pricing through 2012/13. The reason the low stock numbers comes as such a surprise to the markets is that with the worst U.S. drought in half a century decimating crop reserves and spiking grain prices, livestock and ethanol production should plummet.

This effect generally slows the pace of stockpile consumption and dampens the grain price spikes over time. Normally, as margins on ethanol and protein are squeezed by higher grain prices, production of both is reduced. However, the growing global food demand combined with the increased transportation uses has caused "normal" to become irrelevant. Quoted by Reuters, Don Roose, President of U.S. Commodities, said corn consumption for the summer was larger than expected, "so we're going to hear talk that we're going to have to do a better job of rationing in the feed sector. That's not easy to do."

Analysts who do not agree that peak pricing will remain through 2013 therefore remain adamant that eventually, grain dependant livestock or ethanol producers will be forced to generate less product as their margins are squeezed. With less production comes less grain demand, and corresponding price reductions. Often, in that scenario, restaurant operators intuitively assume that as grain pricing eases, meat pricing will closely follow, but the herd economics and long protein cycle actually complicates that line of thought.

Herd Size & Cycles: Herd size is a phrase regularly discussed around the industry. It is specific to cattle, but a reader can apply the economics of a herd cycle to most protein categories (just note that each protein varies in length of cycle). With cattle, the individual animals comprising the herds are generally used for three primary categories: 1) dairy are the cows milked to provide our cheese,

milk and ice-cream; 2) "fed" cows are those born, fed and cared for specifically to one day become beef for human consumption; and 3) breeding stock, these are the animals held out of the slaughter or dairy cycles in order to increase the size of the herd (inventory levels).

Cattle farmers manage the herd sizes and allocations to the categories above based on the economics of the markets. But unlike manufacturing widgets, the economics around live inventories are dynamic. Building inventories of cows is a daily risk assessment . . . cows must be fed. Every day a cow remains alive and in the herd, the farmer comes out of pocket for feed/care and invests in that particular animal's potential to generate a return. The math around the assumed return is based on the cost of keeping the animal fed and alive versus a reasonable expected return related to beef or dairy pricing.

However, when grain dramatically spiked due to the drought, the cost of building inventory became so high that the farmer questioned the rationale for the increased cost of investment. The result in many cases was that the farmer chose to reduce his exposure to higher grain prices by reducing herd size.

This impacts each of the categories described above: a dairy cow that would have otherwise produced milk products may be slaughtered for meat; a smaller/younger cow previously designated to be fattened into adulthood may be prematurely taken to the packing house; finally, a breeding cow otherwise kept alive to increase the herd size may be sacrificed.

Already for months now, the nation's cattle inventory has been at the lowest levels since the USDA began an annual count (this amidst a continued consumer population expansion), yet the recent grain spike has caused producers to cull herds even further. The resulting irony is that protein prices may temporarily ease as livestock producers decide to slaughter more animals rather than suffering the higher cost of feed.

By early 2013, prices are expected to spike as a result of the smaller livestock herds and shrunken meat supplies. Next year, the USDA says beef prices are expected to jump at least 5%, making it among the biggest price hikes the industry faces. Dairy prices are expected to climb 4.5%; poultry and egg prices up by 4%; and pork prices up by

at least 3.5%. These price hikes, at least in the case of large livestock, are due mostly to the dwindling current supply.

In other words, almost no matter what happens to the price of grain going forward, farmers have already made the decision to slaughter – the damage to herd size is done and may even worsen with sustained grain pricing. The herds must eventually be re-built. Most important to understanding the pricing paradigm of the next several years is one thing: re-building takes years. From gestation, to weaning, to adulthood and finally to slaughter, it takes years.

"The drought is the last in a series of events that have hurt the industry," says Dr. Derrell Peel, Oklahoma State University Extension Livestock Marketing Specialist. "The timing of the drought couldn't have been worse. But we didn't get into this predicament overnight, and we're not going to get out of it quickly either."

According to the Southwest Farm Press, Peel says he expects recovery to take 4 to 5 years before herds can be significantly reestablished, and says a more patient approach will be necessary before the industry can experience expansion and return to pre-drought conditions. Therefore, industry participants should not view recent headlines around high beef prices, global bacon shortages and threats of empty chicken wing platters during the Super Bowl as short-term events. While it is true that most proteins have shorter cycle times than beef, it should be expected that the price spike associated with the drought will impact the restaurant industry for several years to come.

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