TRINITY CAPITAL
INVESTMENT BANKING

Restaurant Industry Commentary
&
3rd Quarter 2014 SSS

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Same-Store Sales Discussion and Analysis

During the third quarter of 2014 ("Q3 2014"), the restaurant industry maintained positive momentum in same-store sales, up by 3.1% year-over-year. In fact, the industry reported its 18th consecutive quarter of same-store sales gains. This is particularly impressive considering that third quarter same-store sales have been positive for the past five years, which means the industry is comping over very strong numbers. It should be noted, however, that traffic has not been nearly as strong as sales, so the gains are largely attributed to increased prices rather than increased customer visits.

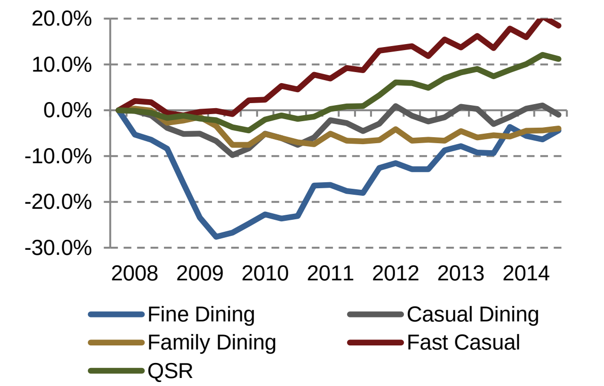
In the fine dining segment, the companies we track were up year-over-year by an average of 5.5% for Q3 2014. It is important to note that despite 19 consecutive positive quarters, fine dining sales remain below pre-recession levels (see Cumulative Same-Store Sales graph). Nonetheless, these gains represent real momentum given the positive results over the last three years.

In the casual dining segment, the concepts we follow were up year-over-year by an average of 2.3% for Q3 2014. This is the second consecutive quarter that the casual dining segment has posted positive same-store sales results. According to Knapp-Track, casual dining guest counts were down 1.5% in July, down 2.0% in August and down 1.0% in September. In fact, Knapp-Track has reported negative guest counts in 60 of the last 69 months. We expect to start seeing more positive guest count numbers in the coming months as the segment comps over nearly six years of negative numbers. In the family dining segment, the concepts we track reported an average increase in same-store sales of 2.0% during Q3 2014.

The fast casual segment continued its positive momentum and stretch of 20 consecutive quarters of positive comps. The segment was up 4.3% for Q3 2014. The fast casual segment continues to produce positive same-store sales results despite comping over nearly five years of strong growth.

In the QSR segment, 15 of the 18 concepts we track saw positive same-store sales growth during Q3 2014, while the segment was up an average of 3.1%. The chicken-QSR segment had a strong showing in the third quarter, up an average of 5.0% with Popeye's leading the way, up 7.2%, followed by Pollo Tropical at 5.9%.

Cumulative Same-Store Sales Change by Segment



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

The restaurant industry posted its best sales results in the last two and a half years during Q3 2014, amid continuing signs of economic growth. Consumer confidence, real disposable income, the labor market and overall economic growth have improved. Additionally, the steep drop in gasoline prices, which leaves consumers with more cash for discretionary spending, has been very helpful to restaurant traffic.

We expect same-store sales in the fourth quarter to continue to be strong, as last year the restaurant industry was plagued by severe winter storms and a shortened shopping season due to a late Thanksgiving. The late Thanksgiving hurt same-store sales for those segments that typically have lower weekly sales due to that holiday, such as casual dining and fine dining. Therefore, the favorable weather and holiday calendar in 2014 will likely lead to a very strong fourth quarter in 2014.

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

Same-Store Sales ("SSS") Data

	FY 2011		FY 2012				FY 2013				FY 2014		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Fine Dining													
Fleming's	10.1%	0.3%	5.4%	6.8%	10.1%	4.0%	5.4%	2.0%	4.2%	4.9%	1.7%	3.6%	4.8%
Ruth's Chris	2.6%	7.7%	3.7%	6.0%	5.9%	5.4%	6.6%	4.6%	4.2%	5.5%	2.6%	2.8%	4.8%
Capital Grille	7.0%	5.7%	5.7%	2.8%	4.0%	2.3%	3.0%	4.5%	3.2%	6.7%	0.1%	0.8%	3.9%
Del Frisco's	N/A	N/A	7.9%	7.3%	5.3%	5.9%	1.9%	5.9%	4.4%	5.2%	5.1%	5.2%	8.4%
Mean	**6.6%**	**4.6%**	**5.7%**	**5.7%**	**6.3%**	**4.4%**	**4.2%**	**4.3%**	**4.0%**	**5.6%**	**2.4%**	**3.1%**	**5.5%**
Casual Dining													
Applebee's	(0.3%)	1.0%	1.2%	0.4%	2.0%	0.9%	(1.3%)	1.3%	(0.4%)	(0.3%)	(0.5%)	0.6%	1.7%
BJ's Restaurants	6.5%	5.1%	3.3%	4.4%	2.3%	3.0%	(0.4%)	0.0%	(2.2%)	(2.7%)	(2.9%)	(1.7%)	0.3%
Bonefish	7.4%	5.9%	6.2%	2.1%	3.5%	1.0%	0.5%	0.2%	(2.7%)	0.9%	(1.5%)	0.3%	2.6%
Buffalo Wild Wings	4.8%	7.1%	8.1%	5.4%	6.0%	6.7%	1.9%	4.0%	4.3%	4.0%	5.7%	7.0%	5.8%
Carrabba's Italian Grill	6.3%	3.5%	4.3%	1.5%	1.0%	(0.4%)	(1.7%)	0.3%	0.0%	0.9%	(1.8%)	(1.2%)	(1.2%)
Cheesecake Factory	0.8%	2.7%	2.6%	2.1%	2.9%	1.3%	1.6%	0.9%	1.0%	1.1%	1.2%	1.5%	2.1%
Chili's Grill & Bar	1.7%	1.4%	4.6%	2.2%	2.8%	1.0%	(1.1%)	(0.6%)	(1.9%)	0.2%	0.5%	2.5%	2.3%
Dave & Buster's	2.7%	(0.9%)	(0.3%)	5.4%	5.4%	3.7%	1.8%	(0.9%)	(0.9%)	2.4%	0.7%	4.7%	8.7%
Famous Dave's	(0.1%)	3.6%	(1.6%)	(0.6%)	0.2%	(6.0%)	(1.8%)	3.8%	(2.3%)	(1.1%)	(3.3%)	(2.8%)	(2.3%)
Granite City	3.0%	4.0%	1.9%	1.5%	2.5%	4.5%	2.7%	2.5%	0.4%	0.6%	N/A	N/A	N/A
LongHorn Steakhouse	4.8%	6.7%	3.8%	3.0%	2.2%	(0.8%)	(1.6%)	3.5%	3.2%	2.9%	0.3%	2.4%	2.8%
Maggiano's	3.5%	2.8%	3.9%	1.9%	0.9%	0.6%	0.4%	0.2%	0.6%	0.9%	0.2%	0.9%	0.6%
Olive Garden	(2.9%)	(2.5%)	2.0%	(1.8%)	0.3%	(3.2%)	(4.1%)	1.1%	(4.0%)	(0.6%)	(5.4%)	(4.2%)	(1.3%)
Outback	6.0%	3.6%	5.3%	2.3%	4.5%	5.3%	2.5%	2.8%	(0.3%)	1.1%	0.8%	0.9%	4.8%
Red Lobster	10.7%	6.8%	6.0%	(3.9%)	(2.6%)	(2.7%)	(6.6%)	3.2%	(5.2%)	(4.5%)	(8.8%)	(5.6%)	N/A
Red Robin	2.1%	4.5%	1.0%	1.2%	0.6%	1.4%	1.4%	3.6%	5.4%	3.7%	5.8%	1.6%	1.4%
Ruby Tuesday	(4.1%)	(4.2%)	(5.0%)	(4.6%)	1.9%	0.3%	(2.8%)	(3.1%)	(11.4%)	(7.8%)	(1.9%)	0.4%	1.1%
Taco Cabana	5.3%	2.7%	6.1%	4.5%	1.8%	6.8%	2.0%	1.1%	1.8%	(2.9%)	0.8%	2.8%	3.5%
Texas Roadhouse	3.9%	5.6%	6.2%	4.6%	3.9%	4.5%	3.7%	4.7%	2.9%	2.5%	3.0%	3.0%	5.8%
Mean	**3.3%**	**3.1%**	**3.1%**	**1.7%**	**2.2%**	**1.5%**	**(0.2%)**	**1.5%**	**(0.6%)**	**0.1%**	**(0.4%)**	**0.7%**	**2.3%**
Family Dining													
Bob Evans	(1.5%)	1.6%	(0.6%)	1.0%	1.0%	1.6%	0.0%	(0.6%)	(1.9%)	(1.8%)	(4.1%)	(2.0%)	N/A
Denny's	0.9%	1.6%	2.4%	0.8%	0.4%	1.7%	(0.7%)	0.6%	1.2%	0.9%	1.8%	1.9%	2.4%
Frisch's Big Boy	0.0%	0.4%	1.7%	(1.7%)	(0.2%)	(1.7%)	(0.9%)	1.0%	(0.1%)	0.0%	(3.6%)	0.7%	1.8%
IHOP	(1.5%)	(1.0%)	(0.5%)	(1.4%)	(2.0%)	(2.6%)	(0.5%)	1.9%	3.6%	4.5%	3.9%	3.2%	2.4%
Luby's	3.5%	2.2%	2.2%	1.1%	2.4%	0.2%	(0.1%)	1.0%	2.4%	1.2%	2.2%	4.4%	1.4%
Mean	**0.3%**	**1.0%**	**1.0%**	**(0.0%)**	**0.3%**	**(0.2%)**	**(0.4%)**	**0.8%**	**1.0%**	**1.0%**	**0.0%**	**1.6%**	**2.0%**

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

SSS Data (Cont'd)

	FY 2011		FY 2012				FY 2013				FY 2014		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Fast Casual													
Chipotle	11.3%	11.1%	12.7%	10.2%	4.8%	3.8%	1.0%	5.5%	6.2%	9.3%	13.4%	17.3%	19.8%
Cosi	(3.0%)	2.6%	7.5%	(0.5%)	(0.7%)	(3.9%)	(4.5%)	(2.7%)	(3.6%)	(4.6%)	(9.5%)	(4.7%)	(1.9%)
Einstein Noah Bagel	0.7%	1.2%	1.1%	1.3%	0.2%	1.4%	(0.6%)	0.7%	(1.4%)	0.1%	1.6%	1.6%	1.6%
Noodles & Company	5.2%	5.4%	6.8%	6.8%	3.4%	4.2%	2.2%	4.7%	2.1%	3.9%	(1.6%)	0.2%	1.7%
Panera Bread	4.4%	4.4%	6.3%	5.9%	5.8%	4.9%	3.3%	3.7%	1.3%	1.1%	0.1%	0.1%	1.4%
Qdoba Mexican Grill	4.3%	3.8%	3.0%	2.1%	3.3%	1.0%	(1.5%)	1.3%	2.0%	2.3%	7.0%	7.5%	7.7%
Steak n Shake	5.3%	5.5%	5.5%	4.8%	2.9%	3.8%	1.3%	0.3%	4.2%	2.2%	3.0%	3.7%	0.0%
Mean	**4.0%**	**4.9%**	**6.1%**	**4.4%**	**2.8%**	**2.2%**	**0.2%**	**1.9%**	**1.5%**	**2.0%**	**2.0%**	**3.7%**	**4.3%**
QSR													
Chicken													
KFC	(3.0%)	(1.0%)	2.0%	1.0%	4.0%	4.0%	4.5%	3.0%	(4.0%)	(5.0%)	(3.0%)	(2.0%)	2.0%
Pollo Tropical	7.9%	7.8%	9.4%	7.8%	7.0%	8.3%	3.8%	6.4%	6.5%	7.0%	6.3%	6.7%	5.9%
Popeye's	1.7%	5.9%	8.1%	8.4%	6.8%	6.4%	0.5%	4.3%	5.1%	0.3%	4.3%	3.8%	7.2%
Mean	**2.2%**	**4.2%**	**6.5%**	**5.7%**	**5.9%**	**6.2%**	**2.9%**	**4.6%**	**2.5%**	**0.8%**	**2.5%**	**2.8%**	**5.0%**
Coffee/Snack													
Baskin Robbins	1.7%	5.8%	9.4%	4.6%	1.1%	1.5%	(4.4%)	1.6%	4.2%	2.2%	0.5%	4.2%	5.8%
Dunkin Donuts	6.0%	7.4%	7.2%	4.0%	4.0%	3.2%	1.7%	4.0%	4.2%	3.5%	1.2%	1.8%	2.0%
Jamba Juice	3.3%	7.7%	12.7%	5.7%	2.5%	0.6%	1.3%	1.7%	(3.4%)	0.3%	0.6%	2.5%	3.7%
Krispy Kreme	4.0%	8.3%	2.1%	5.4%	6.8%	7.5%	11.4%	10.0%	3.7%	1.6%	3.3%	2.3%	3.7%
Starbucks	10.0%	9.0%	8.0%	7.0%	7.0%	7.0%	7.0%	9.0%	8.0%	5.0%	6.0%	6.0%	5.0%
Tim Horton's	6.3%	7.2%	8.5%	4.9%	2.3%	3.2%	(0.5%)	1.4%	3.0%	3.1%	1.9%	5.9%	6.8%
Mean	**5.2%**	**7.6%**	**8.0%**	**5.3%**	**4.0%**	**3.8%**	**2.8%**	**4.6%**	**3.3%**	**2.6%**	**2.3%**	**3.8%**	**4.5%**
Mexican													
Taco Bell	(2.0%)	(2.0%)	6.0%	13.0%	7.0%	5.0%	6.0%	2.0%	2.0%	1.0%	(1.0%)	2.0%	3.0%
Mean	**(2.0%)**	**(2.0%)**	**6.0%**	**13.0%**	**7.0%**	**5.0%**	**6.0%**	**2.0%**	**2.0%**	**1.0%**	**(1.0%)**	**2.0%**	**3.0%**
Pizza													
Domino's	3.0%	6.8%	2.0%	1.7%	3.3%	4.7%	6.2%	6.7%	5.4%	3.7%	4.9%	5.4%	7.7%
Papa John's	5.3%	1.7%	1.1%	5.7%	2.5%	5.2%	1.6%	3.4%	1.8%	6.6%	9.6%	6.0%	7.4%
Pizza Hut	(3.0%)	6.0%	5.0%	4.0%	6.0%	(1.0%)	(1.0%)	(2.0%)	(1.0%)	(4.0%)	(5.0%)	(4.0%)	(2.0%)
Mean	**1.8%**	**4.8%**	**2.7%**	**3.8%**	**3.9%**	**3.0%**	**2.3%**	**2.7%**	**2.1%**	**2.1%**	**3.2%**	**2.5%**	**4.4%**
Sandwich													
Burger King	(0.3%)	(2.0%)	4.2%	4.4%	1.6%	3.7%	(3.0%)	(0.5%)	(0.3%)	0.2%	0.1%	0.4%	3.6%
Jack in the Box	5.8%	5.3%	5.6%	3.4%	3.1%	1.9%	0.1%	0.1%	(1.4%)	1.9%	0.7%	2.4%	3.1%
McDonald's	4.4%	7.1%	8.9%	3.6%	1.2%	0.3%	(1.2%)	1.0%	0.7%	(1.4%)	(1.7%)	(1.5%)	(3.3%)
Sonic Drive-In	(0.5%)	0.1%	3.5%	2.8%	2.3%	3.0%	1.3%	0.1%	5.9%	2.2%	1.4%	5.3%	0.0%
Wendy's	0.9%	4.4%	0.7%	3.2%	2.8%	(0.5%)	0.7%	0.3%	3.1%	2.9%	0.7%	3.2%	0.8%
Mean	**2.1%**	**3.0%**	**4.6%**	**3.5%**	**2.2%**	**1.7%**	**(0.4%)**	**0.2%**	**1.6%**	**1.2%**	**0.2%**	**2.0%**	**0.8%**
Mean Total QSR	**2.9%**	**4.8%**	**5.8%**	**5.0%**	**4.0%**	**3.6%**	**2.0%**	**2.9%**	**2.4%**	**1.7%**	**1.7%**	**2.8%**	**3.5%**

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

Impact of Millennials on the Restaurant Industry

Today, the Millennial Generation, generally defined as those born between 1980 and 1999, accounts for approximately 90 million or roughly one-third of the U.S. population. Millennials represent a large and diverse customer base, raised in the age of the internet and cell phones. They are technologically savvy, view dining out as a social event and rely heavily on word-of-mouth and customer reviews posted on technology platforms such as Yelp. Restaurant chains are working feverishly to attract this new generation, some with greater success than others.

Here is what we know:

Millennials are high frequency customers – Millennials dine out more than any other generation. According to Technomic, 41% of Millennials purchase food away from home at least twice a week compared to 38% and 37% for Generation X and Baby Boomers, respectively.

Millennials use restaurants as a gathering place – Increasingly, restaurants serve as a gathering place for Millennials. With higher unemployment and less disposable income within this age group, many Millennials have found themselves moving back home and living with their parents. This dynamic makes dining out an important experience to share with friends as an opportunity to socialize. Accordingly, restaurants need to provide an atmosphere that caters to group dining, a menu that offers shareable items and present itself as a "hip" or "worthy of posting on Instagram" place to meet.

Millennials are knowledgeable about food – Millennials care about the quality of the menu offerings, appreciate locally-sourced ingredients and prefer companies that are viewed as socially responsible. With access to information at their fingertips via mobile devices, Millennials are able to make informed decisions when deciding where and what to eat. The Millennial customer wants healthy food options, and they want to dine at a restaurant that shares the same values. For example, Chipotle has been extremely successful in promoting its brand as "Food with Integrity." Customers know the pork, beef and chicken served at Chipotle restaurants are naturally raised in a humane way, and that drives repeat visitors and brand loyalty.

Millennials crave customizable and unique options – When Millennials choose which restaurant to visit; an important consideration is the ability to customize their meal. In a recent Technomic study, 21% of the Millennials surveyed indicated that they are drawn to restaurants that offer the ability to customize a meal compared to 16% and 15% for Generation X and Baby Boomers, respectively. The success of restaurants such as PizzaRev, The Counter, Chipotle and others centers on the customer's ability to control which ingredients go into their meals.

Millennials are price sensitive, yet demanding – Faced with the challenges of the recent recession, limited job opportunities and stagnant wages, Millennials are very price sensitive and look for an attractive price-to-value ratio. However, this same value-orientated group expects and demands a diverse menu offering, high-quality ingredients and a modern, social atmosphere. Restaurateurs need to navigate these waters carefully to capture the finicky Millennial diner and be able to generate profits at the same time.

By 2020, it is estimated that Millennials will represent 50% of the U.S. workforce and will undoubtedly be an important driver of success for all restaurant brands. In order to survive in the ever-evolving restaurant industry, companies need to pay close attention to the trends and habits of Millennials and be able to respond quickly. Those that don't will find themselves playing "catch-up" similar to what McDonald's and other long-standing brands face today.

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Will Restaurant Performance Continue at this Torrid Pace?

Well, the short answer is we sure hope so. A compendium of factors has coalesced to support and even positively accelerate restaurant results during the past several months. Oil prices have fallen from over $100 per barrel to below $50, reducing gasoline prices by at least $1.20 per gallon in most major cities. For a family consuming 30 gallons per week, this is just under $2,000 per year, and that has translated into increased disposable income. A good portion of that income is finding its way into restaurant results through increasing sales, traffic, profits and share prices of publicly traded restaurant companies.

Another factor helping restaurants is that comparable results for 2015 versus the prior year for most parts of the nation (clearly not New England!) are very good. The Southeastern, Midwestern and Western United States have had very strong restaurant sales, as compared to last year, as a result of better weather. However, New England and New York State have had a harsh winter thus far in 2015.

Food commodity price decreases, in addition to gasoline price decreases, have improved the bottom line of many concepts in the last few months. Dairy prices are down 24% year-over-year in January 2015 and corn and wheat are both down 12% and 10%, respectively, over the same time frame. For the calendar year 2015, large QSR food co-ops have reviewed their initial assumptions and are now forecasting modest reductions in food cost projections. Some chains have recently locked in attractive commodity prices, which are below pricing in 2014, through hedges and forward contracts. Finally, crop yields from 2014 were better than initially forecasted for many of the principal grains such as wheat, corn and soy. Corn and soy experienced record yields in 2014.

Fast casual and higher-end QSR concepts, which have substantial Millennial customer bases, have continued to take customers from traditional QSR concepts at a steady pace through social media and targeted advertising. While it may not be fair to say that mainstay QSR concepts are hemorrhaging Millennials, the data strongly suggests that this demographic is continuing to move away from many iconic names in the QSR space.

Another aspect of restaurant performance that is often overlooked is the steady drumbeat of efficiency through better practices, equipment, IT solutions, management and consolidation. There has been a consistent decrease in the cost of operating restaurants (as a percentage of sales) through these developments, as witnessed by a substantial decline in general and administrative expenses (G&A) in the industry. Many mainstay QSR concepts historically averaged G&A of 5% of sales or more, and now we are frequently seeing G&A costs in the 3% range. A number of factors are baked into this improvement, including higher sales, better reporting and analytics, increased scale and purchasing power, better software and more intensive management. Restaurant operators have increasingly focused on cost management in an industry that was previously so profitable that costs were managed, but not always with vigilance. Today, restaurant operators are focused on pursuing cost improvements in taxes, utilities, paper costs and many other categories in addition to the typical labor and food costs.

Consumer debt is on the rise again as Americans feel better about the economy than they did perhaps during the middle of the Great Recession in 2009. Regardless of the questionable quality of the recent economic data, unemployment, housing and GDP growth have been better in the United States than anywhere else in the world, creating higher confidence among American consumers than elsewhere. Even those that are not as well off as they were in 2009 are throwing caution to the wind and taking on credit card debt that reverses the deleveraging American consumers engaged in during 2009 and 2010. This may not be good news for the economy long-term, but clearly restaurants are among the winners from these developments.

All of these improvements have been very kind to the stock market and restaurant stocks. IPOs from last year are all trading above their initial offer price, with the average increase at approximately 75%. Key public restaurant stocks, including Chipotle (price-to-earnings ratio ("P/E") of 46.9), Noodles & Company (P/E of 49.8) and Chuy's (P/E of 33.9) are trading at very lofty and noteworthy valuation multiples.

In summary, while there are a lot of risks and headwinds facing the U.S. economy and the broader global economy; including political uncertainties in the Middle East, Russia and parts of Europe, we expect consumers to continue to dine away from home until there is a perceptible change in the economy.

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