TRINITY CAPITAL
INVESTMENT BANKING

3rd Quarter 2013

Restaurant Industry Commentary

What's Inside This Commentary	

Same-Store Sales Discussion and Analysis

During the third quarter of 2013 ("Q3 2013"), the restaurant industry maintained positive momentum in same-store sales, which is impressive as we continue to comp over positive results from the prior two years. In fact, the industry reported its fourteenth consecutive quarter of same store sales gains. It should be noted, however, that traffic has slowed or declined within many prominent chains, so the gains can be attributed to price increases opposed to increased customer visits.

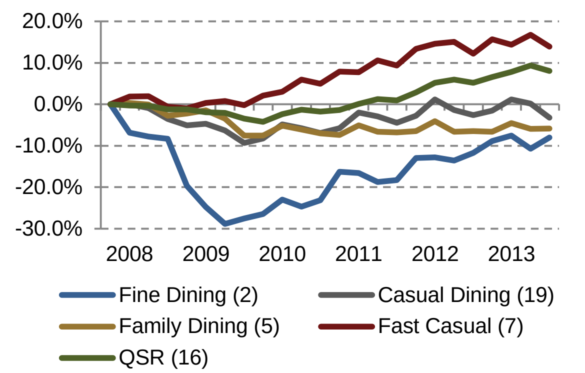
In fine dining, the companies we track were up from 2012 by an average of 4.2% for Q3 2013. It is important to note that despite 15 consecutive positive quarters, fine dining sales remain well below pre-recession levels. Nonetheless, these gains represent real momentum given the last three years' positive results.

In casual dining, the concepts we follow were down by an average of 0.7% for Q3 2013. This is the second out of the last fourteen quarters that the casual dining segment has posted negative quarterly same-store sales results. According to Knapp-Track, casual dining guest counts were down 4.4% in July, up 3.2% in August and down 3.6% in September. In fact, Knapp-Track has reported negative guest counts in 21 of the last 26 months. We expect to start seeing more positive guest count numbers in the coming months as the segment comps over two plus years of negative numbers. The family dining concepts we track reported an average increase in same-store sales of 0.6% during Q3 2013.

The fast casual segment continued to lead the industry with another positive quarter after a minor setback in the first quarter of 2013, when the segment suffered its first same-store sales decline since the second quarter of 2009. The segment was up 1.5% for Q3 2013. The fast casual segment continues to produce positive same-store sales results despite comping over nearly four years of strong growth.

In the QSR segment, 11 of the 16 concepts we track were positive during the third quarter of 2013 while the segment was up an average of 2.7%. The Coffee/Snack segment had another strong showing in the third quarter, up an average of 4.7% with Krispy Kreme continuing to lead the way, up 10.0%, followed by Starbucks at 8.0%.

Cumulative Same-Store Sales Change by Segment



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

Trinity views the continued declines in traffic counts as a real concern. According to Black Box Intelligence, traffic in comparable stores fell 1.9% during September, a 0.3% decline compared to August. Results for the third quarter were equally challenging, with overall same-store traffic declining 1.8%. Concepts with declining traffic can only increase prices so much to maintain positive same-store sales results before they lose customers permanently. We recommend that restaurant operators focus on solid operations and customer satisfaction in order to maintain their traffic counts as we wait for the economy to stabilize and overall traffic numbers to improve.

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

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Same-Store Sales ("SSS") Data

	FY 2011				FY 2012				FY 2013		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Fine Dining											
Fleming's	11.4%	9.9%	10.1%	0.3%	5.4%	6.8%	10.1%	4.0%	5.4%	2.0%	4.2%
Ruth's Chris	5.2%	5.8%	2.6%	7.7%	3.7%	6.0%	5.9%	5.4%	6.6%	4.6%	4.2%
Mean	**8.3%**	**7.9%**	**6.4%**	**4.0%**	**4.6%**	**6.4%**	**8.0%**	**4.7%**	**6.0%**	**3.3%**	**4.2%**
Casual Dining											
Applebee's	3.9%	3.1%	-0.3%	1.0%	1.2%	0.4%	2.0%	0.9%	-1.3%	1.3%	-0.4%
Benihana	5.6%	6.0%	6.4%	7.0%	4.8%	4.5%	-	-	-	-	-
BJ's Restaurants	7.8%	6.9%	6.5%	5.1%	3.3%	4.4%	2.3%	3.0%	-0.4%	0.0%	-2.2%
Bonefish	9.6%	10.2%	7.4%	5.9%	6.2%	2.1%	3.5%	1.0%	0.5%	0.2%	-2.7%
Buffalo Wild Wings	2.4%	3.9%	4.8%	7.1%	8.1%	5.4%	6.0%	6.7%	1.9%	4.0%	4.3%
Carrabba's Italian Grill	3.9%	4.8%	6.3%	3.5%	4.3%	1.5%	1.0%	-0.4%	-1.7%	0.3%	0.0%
CEC Entertainment	1.1%	-2.0%	-6.3%	-3.6%	-4.2%	-2.4%	-2.3%	-2.9%	1.6%	2.9%	-2.1%
Cheesecake Factory	2.1%	2.3%	0.8%	2.7%	2.6%	2.1%	2.9%	1.3%	1.6%	0.9%	1.0%
Chili's Grill & Bar	-3.0%	2.1%	1.7%	1.4%	4.6%	2.2%	2.8%	1.0%	-1.1%	-0.6%	-1.9%
Dave & Buster's	5.3%	1.9%	2.7%	-0.9%	-0.3%	5.4%	5.4%	3.7%	1.8%	-0.9%	-0.9%
Famous Dave's	3.0%	-1.2%	-0.1%	3.6%	-1.6%	-0.6%	0.2%	-6.0%	-1.8%	3.8%	-2.3%
Frisch's Golden Corral	-0.9%	-3.6%	-4.9%	7.8%	12.4%	-	-	-	-	-	-
Granite City	3.8%	3.5%	3.0%	4.0%	1.9%	1.5%	2.5%	4.5%	2.7%	2.5%	0.4%
LongHorn Steakhouse	6.1%	6.0%	4.8%	6.7%	3.8%	3.0%	2.2%	-0.8%	-1.6%	3.5%	3.2%
Maggiano's	3.4%	5.7%	3.5%	2.8%	3.9%	1.9%	0.9%	0.6%	0.4%	0.2%	0.6%
Olive Garden	0.0%	0.0%	-2.9%	-2.5%	2.0%	-1.8%	0.3%	-3.2%	-4.1%	1.1%	-4.0%
Outback	4.3%	1.8%	6.0%	3.6%	5.3%	2.3%	4.5%	5.3%	2.5%	2.8%	-0.3%
Red Lobster	0.1%	3.8%	10.7%	6.8%	6.0%	-3.9%	-2.6%	-2.7%	-6.6%	3.2%	-5.2%
Red Robin	2.1%	2.9%	2.1%	4.5%	1.0%	1.2%	0.6%	1.4%	1.4%	3.6%	5.4%
Ruby Tuesday	-1.2%	-0.1%	-4.1%	-4.2%	-5.0%	-4.6%	1.9%	0.3%	-2.8%	-3.1%	-11.4%
Taco Cabana	2.0%	4.5%	5.3%	2.7%	6.1%	4.5%	1.8%	6.8%	2.0%	1.1%	1.8%
Texas Roadhouse	4.5%	4.3%	3.9%	5.6%	6.2%	4.6%	3.9%	4.5%	3.7%	4.7%	2.9%
Mean	**3.0%**	**3.0%**	**2.6%**	**3.2%**	**3.3%**	**1.6%**	**2.0%**	**1.3%**	**-0.1%**	**1.6%**	**-0.7%**
Family Dining											
Bob Evans	1.2%	-1.8%	-1.5%	1.6%	-0.6%	1.0%	1.0%	1.6%	0.0%	-0.6%	-1.9%
Denny's	-1.7%	2.0%	0.9%	1.6%	2.4%	0.8%	0.4%	1.7%	-0.7%	0.6%	1.2%
Frisch's Big Boy	0.2%	0.5%	0.0%	0.4%	1.7%	-1.7%	-0.2%	-1.7%	-0.9%	1.0%	-0.1%
IHOP	-2.7%	-2.9%	-1.5%	-1.0%	-0.5%	-1.4%	-2.0%	-2.6%	-0.5%	1.9%	3.6%
Luby's	3.5%	-0.6%	3.5%	2.2%	2.2%	1.1%	2.4%	0.2%	-0.1%	1.0%	0.2%
Mean	**0.1%**	**-0.6%**	**0.3%**	**1.0%**	**1.0%**	**0.0%**	**0.3%**	**-0.2%**	**-0.4%**	**0.8%**	**0.6%**

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

SSS Data (Cont'd)

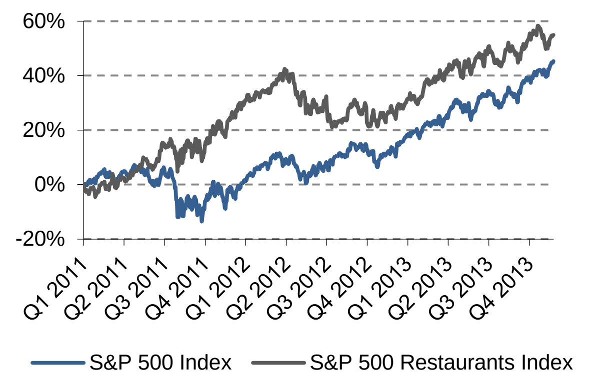
	FY 2011				FY 2012				FY 2013		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Fast Casual											
Chipotle	12.4%	10.0%	11.3%	11.1%	12.7%	10.2%	4.8%	3.8%	1.0%	5.5%	6.2%
Cosi	1.7%	-0.2%	-3.0%	2.6%	7.5%	-0.5%	-0.7%	-3.9%	-4.5%	-2.7%	-5.0%
Einstein Noah Bagel	-0.4%	0.2%	0.7%	1.2%	1.1%	1.3%	0.2%	1.4%	-0.6%	0.7%	-1.4%
Panera Bread	3.3%	3.9%	4.4%	4.4%	6.3%	5.9%	5.8%	4.9%	3.3%	3.7%	1.3%
Qdoba Mexican Grill	6.0%	5.1%	4.3%	3.8%	3.0%	2.1%	3.3%	1.0%	-1.5%	1.3%	2.0%
Steak n Shake	4.3%	4.9%	5.3%	5.5%	5.5%	4.8%	2.9%	3.8%	1.3%	0.3%	4.2%
Tim Horton's (US)	4.9%	6.4%	6.3%	7.2%	8.5%	4.9%	2.3%	3.2%	-0.5%	1.4%	3.0%
Mean	**4.6%**	**4.3%**	**4.2%**	**5.1%**	**6.4%**	**4.1%**	**2.7%**	**2.0%**	**-0.2%**	**1.5%**	**1.5%**
QSR											
Chicken											
KFC	1.0%	-5.0%	-3.0%	-1.0%	2.0%	1.0%	4.0%	4.0%	4.5%	3.0%	-4.0%
Pollo Tropical	13.5%	10.7%	7.9%	7.8%	9.4%	7.8%	7.0%	8.3%	3.8%	6.4%	6.5%
Popeye's	3.9%	0.5%	1.7%	5.9%	8.1%	8.4%	6.8%	6.4%	0.5%	4.3%	5.1%
Mean	**6.1%**	**2.1%**	**2.2%**	**4.2%**	**6.5%**	**5.7%**	**5.9%**	**6.2%**	**2.9%**	**4.6%**	**2.5%**
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%	4.0%	4.2%
Jamba Juice	2.2%	4.3%	3.3%	7.7%	12.7%	5.7%	2.5%	0.6%	1.3%	1.7%	-3.4%
Krispy Kreme	7.0%	2.5%	4.0%	8.3%	2.1%	5.4%	6.8%	7.5%	11.4%	11.4%	10.0%
Starbucks	7.0%	8.0%	10.0%	9.0%	8.0%	7.0%	7.0%	7.0%	7.0%	9.0%	8.0%
Mean	**4.7%**	**4.5%**	**5.5%**	**7.6%**	**6.5%**	**5.0%**	**4.8%**	**4.6%**	**5.4%**	**6.5%**	**4.7%**
Mexican											
Taco Bell	0.0%	-5.0%	-2.0%	-2.0%	6.0%	13.0%	7.0%	5.0%	6.0%	2.0%	2.0%
Mean	**0.0%**	**-5.0%**	**-2.0%**	**-2.0%**	**6.0%**	**13.0%**	**7.0%**	**5.0%**	**6.0%**	**2.0%**	**2.0%**
Pizza											
Domino's	-1.4%	4.8%	3.0%	6.8%	2.0%	1.7%	3.3%	4.7%	6.2%	6.7%	5.4%
Papa John's	6.1%	0.4%	5.3%	1.7%	1.1%	5.7%	2.5%	5.2%	1.6%	3.4%	1.8%
Pizza Hut	-3.0%	-2.0%	-3.0%	6.0%	5.0%	4.0%	6.0%	-1.0%	-1.0%	-2.0%	-1.0%
Mean	**0.6%**	**1.1%**	**1.8%**	**4.8%**	**2.7%**	**3.8%**	**3.9%**	**3.0%**	**2.3%**	**2.7%**	**2.1%**
Sandwich											
Burger King	-6.0%	-5.3%	-0.3%	-2.0%	4.2%	4.4%	1.6%	3.7%	-3.0%	-0.5%	-0.3%
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%	0.1%	-1.4%
McDonald's	2.9%	4.5%	4.4%	7.1%	8.9%	3.6%	1.2%	0.3%	-1.2%	1.0%	0.7%
Sonic Drive-In	1.2%	3.9%	-0.5%	0.1%	3.5%	2.8%	2.3%	3.0%	1.3%	0.1%	5.9%
Wendy's	0.0%	2.3%	0.9%	4.4%	0.7%	3.2%	2.8%	-0.5%	0.7%	0.3%	3.1%
Mean	**0.6%**	**3.1%**	**2.1%**	**2.7%**	**4.4%**	**3.2%**	**2.9%**	**1.9%**	**0.3%**	**0.2%**	**1.6%**
Mean Total QSR	**2.5%**	**2.6%**	**2.7%**	**4.3%**	**5.1%**	**4.7%**	**4.2%**	**3.6%**	**2.5%**	**3.2%**	**2.7%**

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

What We Learned From 2013

As we review the performance of the U.S. and global markets in 2013, it is clear that a majority of the most widely followed economic statistics present a generally positive picture. The stock market had a banner year with the S&P 500 up 29.6%, the Dow Jones up 26.5% and the IPO market becoming more attractive than it has been since 2007. The S&P 500 Restaurant Index gained nearly 21% in 2013, and private equity interest in the restaurant segment continues to be resilient as many funds explore the arbitrage opportunity between public and private restaurant companies. Many business owners and market pundits are hoping that 2013 was a transitional year in which the economy finally gained enough momentum to relieve itself of the aftereffects of the Great Recession. So the question becomes, will all this good news from 2013 set the table for a repeat of this performance in 2014?

S&P 500 and S&P Restaurant Index Performance



Source: Capital IQ

The chart above illustrates the impressive stock market performance and the relative outperformance of the restaurant index over the broader market during the last three years. In 2013, most restaurant industry participants, even some of the less competitive concepts, enjoyed their best year since the beginning of the Great Recession. Several billion dollars of private restaurant M&A transactions were completed, and the IPO market was very accommodating to companies like Noodles & Company, Potbelly Corporation and Chuy's Holdings, Inc. A number of the more capable concepts started to see a return of meaningful new restaurant development. Finally, one of the hottest topics of year was the steady drumbeat of new reimaging initiatives – underscoring the growing recognition that customers notice curb appeal and that it is highly influential in how they vote with their wallets.

There are a number of catalysts that both directly and indirectly facilitated this financial performance improvement in the restaurant industry during 2013. First and foremost, the industry benefited from the highly accommodative Federal Reserve policy, which included $85 billion per month (or $1 trillion per year) of bond purchases, stimulus and a near rock-bottom federal funds rate. That encouraged banks to increase lending activity at attractive rates for borrowers, which subsequently underpinned business activity and the real estate market. Companies were able to reduce their debt service expenditures and/or invest in new growth projects, thus providing support for the gradual improvement we saw in the labor market. In addition to Federal Reserve policy, the restaurant industry enjoyed higher profit margins in 2013 as a result of declining energy and commodity prices, as well as manageable labor costs.

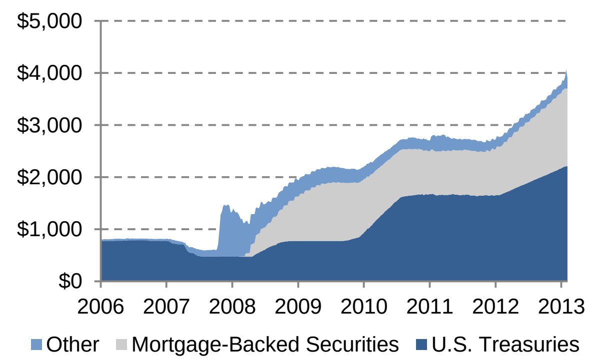
While 2013 was a memorable year for the restaurant industry in general, not every segment and concept had a great year. With a few notable exceptions, the casual dining segment experienced flat to anemic same-store sales growth and declining customer traffic. For the overall restaurant industry, the number of transactions fell from approximately 63 billion in 2012 to roughly 61 billion in 2013, a decrease of more than 3%. In fact, Knapp-Track has reported negative growth rates for year-over-year traffic in 40 of the last 48 months, which indicates that middle class consumers continue to have their belts tightened. In addition to the disconcerting restaurant traffic trends, pending legislation for minimum wage increases and the effects of the Affordable Care Act (Obamacare) may negatively weigh on the financial performance of the restaurant industry in 2014.

When we look at the broader economy, there are a number of other economic statistics that have drawn our attention. While unemployment has fallen to approximately 6.7%, according to the Department of

Labor, the labor participation rate has fallen steadily since 2009 and the youth unemployment rate, compiled by the Bureau of Labor Statistics, is over 15%. Perhaps most concerning, the charts below illustrate the precipitous increase in the U.S. budget deficit and Federal Reserve's balance sheet since the Great Recession.

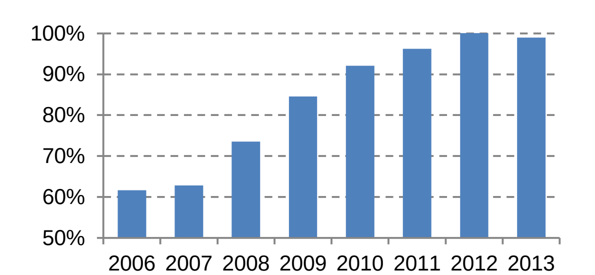
The following two charts raise a few questions as we reflect on 2013 and look forward to 2014: How much is the economic recovery due to improving fundamentals versus how much is due to market intervention by the Federal Reserve? How high can the budget deficit and how big can the Federal Reserve balance sheet get before either becomes more of a problem than a solution? What happens if the Federal Reserve increases its tapering strategy or the U.S. government can no longer afford to reasonably borrow money or pay its debt obligations?

U.S. Federal Reserve Balance Sheet ($ in billions)



Source: Federal Reserve Bank of St. Louis

U.S. Federal Debt as Percent of Gross Domestic Product



Source: Federal Reserve Bank of St. Louis

The discussion of Federal Reserve tapering this past summer pushed credit spreads up a hundred basis points and led to an abrupt stock market selloff. Fortunately, the markets stabilized upon learning that a very modest tapering initiative would be implemented starting in 2014, but it was a clear indication that many believe the economy is vulnerable. By way of example, if the Federal Reserve had reduced its $85 billion per month stimulus to $65 billion during 2013, that would have potentially reduced U.S. GDP by 1.5% and put the economy on the precipice of another recession.

The performance of the restaurant industry in 2014 will be largely centered on the Federal Reserve's stance on tapering and interest rates. It is always difficult to predict the timing of events, so we are keeping a particularly close eye on the Federal Reserve's comments and actions in 2014. Outside of a black swan event, such as a war between the Israelis and the Palestinians, we expect the current trends in the labor market, energy prices and commodity prices to remain fairly bullish for the restaurant industry in the near-term. As we begin 2014, we recall and old Latin adage, *pray for peace, but be prepared for war.*

Contributing Editor, Kevin Burke is a Managing Director for Trinity Capital.

A Case for Agnostic Loss Prevention Solutions

Employee theft, waste, shrinkage and supply chain loss (collectively "loss") cost restaurant brands millions of dollars every year. In an industry known for its razor thin margins any amount of loss is meaningful to restaurant owners and operators. The U.S. Chamber of Commerce reports that approximately 75% of employees steal from the workplace at least once, and half will steal repeatedly. Furthermore, according to the National Restaurant Association, internal employee theft is responsible for roughly 75% of inventory shortages.

The bad news doesn't stop there: losses from employee theft can run as high as 7% of sales annually, which equates to $38 billion industry-wide. In fact, it is rare to complete a forensic audit of a significant franchise operator and not find meaningful avoidable loss. Many routine functions can account for the slippage, including fraudulent voids, deletes, discounts, transfers and returns, as well as workers who take advantage of features such as employee meals or small transactions. Even well run businesses experience employee theft, waste, shrinkage and supply chain loss. The first step in combatting this cost is to diligently track it.

Low wages and high turnover are a potent combination for theft potential. Still, brands and franchise owners do have options when it comes to protecting their businesses. Recently, an MIT Sloan research paper, *Cleaning House: The Impact of Information Technology Monitoring on Employee Theft and Productivity*, demonstrated how restaurants can benefit from having a dedicated loss prevention solution not only by reducing theft, but also by improving employee performance.

The paper examined theft and sales data from 392 restaurant locations belonging to five chains that adopted a theft monitoring information technology product, and revealed significant reductions in misconduct and increases in productivity among workers. As a result, the restaurants, as well as their employees, saw substantial financial gains.

Loss prevention solutions have plenty to offer. However, business owners should take care in choosing the appropriate tool for their restaurants. In order to gain the visibility needed, an effective solution must pull in information from the front of house ("FoH") as well as the back of house ("BoH"). An ideal solution has a third element: the ability to integrate with video.

Point of Sale ("POS") system disparity is a common challenge in franchised QSR environments where restaurant owners have the freedom to choose the software systems that work best for their needs and environment. Yet some loss prevention products are designed to work only with specific systems, putting undue restrictions on business owners. The best solution is one that is platform agnostic, allowing restaurant owners to use their existing POS and BoH software.

Once restaurants are equipped with an agnostic loss prevention tool that features cutting-edge technology, they have the power to systematically identify and therefore significantly reduce theft and improve the bottom line. For example, DelaGet recently conducted a study comparing treatment groups that used our loss prevention tool, with control groups of non-users in the same restaurant concept. The study examined the two groups within three major restaurant brands, and in all three cases the treatment groups showed improvements over their respective control groups.

For Brand A, employee meal threshold exceptions for users was at 1%, compared with 3% for non-users, an improvement of 67%. Small transactions among users were at 4%, compared with 15% among non-users, revealing a 73% improvement.

For Brand B, deleted items after tender were at 3.18% for users and 5.65% for non-users, a 44% improvement. Deleted tickets after tender were at 0.3% for users, compared with 0.4% for non-users, marking an improvement of 23%.

For Brand C, coupon use was at 7.3% for users, versus 8% for non-users, an improvement of 9%. For high couponing businesses, this can represent significant savings.

The ability to integrate the POS and BoH software enables restaurant owners and operators to save money that would otherwise be lost. One of the brands, Taco Bell, leveraged the loss prevention tool to recover 1%, or $20 million annually. Managing loss is critical to overall profitability. Being able to overcome diverse POS systems, as well as combine insights from both the FoH and BoH, delivers a comprehensive "big picture" approach to restaurant transactions.

Loss prevention technology can act as both a carrot and a stick and be used to drive cultural change in the restaurant. When brands or franchise owners introduce transaction compliance within their units and employees understand the full visibility that the loss prevention tool delivers, the solution then serves as a deterrent as well as a tracking tool.

Most restaurateurs prefer to promote a culture of honesty and integrity; rather than catching thieves, they would like to prevent misconduct from taking place at all. Once employees understand that their on-the-job behavior is being monitored, they become highly motivated to act honorably and perform their best, leading to increased net sales as well as higher tips. This is a win-win scenario for both management and employees.

Guest Contributing Editor, Michael Kelly, is the President of DelaGet. For more information on this topic please contact DelaGet at communications@DelaGet.com or visit the DelaGet website at www.DelaGet.com

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