Trinity Capital

4th Quarter 2010 Restaurant Industry Commentary

What's Inside This Commentary

Same-Store Sales Discussion and Analysis

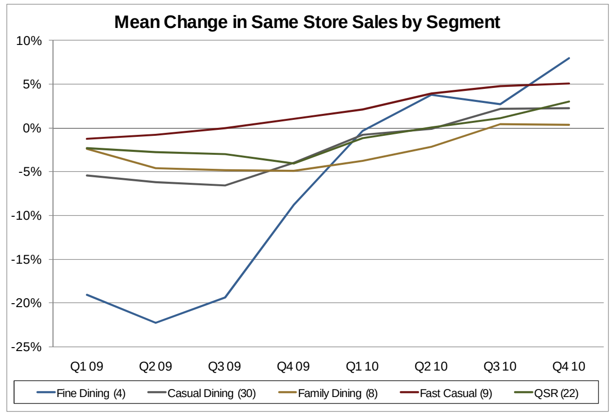
The fourth quarter of 2010 saw continued improvement in same-store sales as we continued to comp over a poor 2009. The first quarter of 2011 may tell a different story as the price of gasoline has continued to rise, a shaky stock market, political unrest in the Middle East and much of the nation experiencing severe weather in January and February.

In fine dining, the companies we track were up from 2009 by an average of 8.0% for the fourth quarter of 2010. It is important to note that these positive sales comps are much lower than the dramatic sales declines the segment experienced during 2009, and their sales continue to be well below pre-recession levels. Nonetheless, this is heroic performance.

In casual dining, the concepts that we track were up by an average of 2.2% over last year. This is the second 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 1.2%, 1.0% and 1.5% for October, November and December, respectively, so a portion of the same store sales stabilization is attributable to price increases as opposed to a robust return of consumer traffic.

The family dining concepts we track were up by an average of 0.3% during the fourth quarter of 2010. The fast casual segment reported positive same-store sales performance for the fifth consecutive quarter. The segment was positive by 5.1% for the fourth quarter of 2010, with all 8 of the concepts we track reporting same-store sales growth.

In the QSR segment, 16 of the 19 concepts we track were positive during the fourth quarter of 2010 while the segment was up by an average of 3.0%. The pizza segment had another strong quarter, up by an average of 5.7%. Pizza Hut led the way, up by 10.0%. This is



the best performance for QSR since the onset of the recession.

While the restaurant recovery is far from complete, the small gains are an important development for an industry that saw some of its worst declines in recent years. High unemployment, rising commodity costs and weak consumer confidence will remain challenging for the industry.

As consumers fall out of love with quaint notions of austere living, restaurants should continue to see gains. Chief among companies to benefit are fast casual concepts, such as Chipotle and Panera Bread. This segment, which is expected to be the fastest growing in the industry, saw a 1.0% increase in visits in 2010, versus casual dining seeing a 2.0% drop, and fine dining restaurants seeing a 3.0% drop, according to the Chicago Tribune.

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Same-Store Sales ("SSS") Data

	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10
Fine Dining:								
Fleming's	-19.9%	-22.4%	-18.0%	-5.7%	5.2%	9.0%	7.3%	18.4%
McCormick & Schmick's	-13.9%	-17.3%	-18.8%	-12.9%	-9.6%	-4.0%	-4.6%	-1.0%
Morton's Rest. Group	-24.1%	-26.1%	-16.8%	-5.3%	3.6%	7.1%	3.2%	5.3%
Ruth's Chris	-18.5%	-23.4%	-24.0%	-11.2%	-0.5%	2.9%	4.9%	9.2%
Mean	**-19.1%**	**-22.3%**	**-19.4%**	**-8.8%**	**-0.3%**	**3.8%**	**2.7%**	**8.0%**
Casual Dining:								
Applebee's	-3.0%	-4.3%	-6.5%	-4.5%	-2.7%	-1.6%	3.3%	2.9%
Benihana	-10.4%	-10.1%	-9.9%	-3.4%	1.4%	2.4%	4.7%	4.4%
BJ's Resturants	-0.1%	-1.3%	-1.6%	-0.2%	4.4%	5.3%	6.7%	5.9%
Bonefish	-10.0%	-8.2%	-5.8%	1.0%	3.6%	5.7%	7.8%	9.3%
Buffalo Wild Wings	6.1%	3.4%	1.5%	2.2%	0.5%	-0.5%	1.1%	-0.8%
California Pizza Kitchen	-5.9%	-6.5%	-8.0%	-5.8%	-2.7%	-5.9%	0.7%	-1.1%
Carrabba's Italian Grill	-7.3%	-5.9%	-7.5%	-3.6%	1.1%	3.5%	4.9%	5.4%
CEC Entertainment	-0.1%	-5.4%	-3.1%	-2.0%	0.7%	-2.2%	3.8%	3.9%
Cheesecake Factory	-3.2%	-3.0%	-2.4%	-0.7%	2.7%	1.6%	2.9%	1.0%
Chili's Grill & Bar	-5.2%	-9.4%	-6.0%	-3.2%	-5.0%	-4.1%	-5.0%	-4.9%
Dave & Buster's	-7.9%	-6.5%	-7.4%	-5.8%	-2.5%	-4.8%	-1.3%	1.2%
Famous Dave's	-5.5%	-9.4%	-6.8%	-3.4%	-3.5%	0.6%	2.4%	-0.8%
Frisch's Golden Corral [1]	2.3%	2.3%	-2.4%	-3.6%	-6.4%	0.7%	4.4%	1.4%
Granite City	-11.2%	-13.2%	-12.7%	-8.1%	2.1%	5.3%	4.0%	3.6%
Landry's	-9.0%	-8.0%	-6.5%	-5.0%	-2.0%	0.0%	-	-
LongHorn Steakhouse	-5.4%	-6.5%	-7.0%	-0.8%	1.9%	1.8%	6.8%	4.5%
Macaroni Grill	-	-	-	-	-	-	-	-
Maggiano's	-9.5%	-9.2%	-6.6%	-1.6%	1.9%	1.3%	1.4%	4.7%
O'Charley's	-2.9%	-6.9%	-7.6%	-7.3%	-6.7%	-7.9%	-2.2%	-1.4%
Olive Garden	-1.4%	-0.6%	-2.9%	-1.4%	1.5%	-1.5%	2.0%	2.0%
On The Border	-5.0%	-5.8%	-5.1%	-4.7%	-	-	-	-
Outback	-8.4%	-10.2%	-10.7%	-5.9%	-2.9%	3.6%	3.0%	2.5%
PF Chang's Bistro	-6.6%	-6.8%	-8.5%	-5.2%	-2.7%	0.1%	2.3%	1.3%
Real Mex	-9.1%	-	-	-	4.3%	-2.2%	-2.4%	-
Red Lobster	-4.6%	-0.6%	-7.9%	-8.4%	0.9%	-4.6%	-1.6%	-1.6%
Red Robin	-7.8%	-11.1%	-14.8%	-10.9%	-2.3%	-1.4%	1.7%	1.6%
Ruby Tuesday	-6.8%	-3.2%	-3.1%	-1.7%	-0.7%	0.3%	1.2%	4.2%
Stoney River	-17.2%	-20.4%	-17.1%	-10.3%	-8.3%	-0.7%	1.7%	3.7%
Taco Cabana	-1.6%	-3.8%	-4.3%	-4.5%	-2.0%	-0.1%	1.0%	2.3%
Texas Roadhouse	-1.4%	-3.7%	-4.4%	-2.3%	0.5%	1.5%	4.3%	3.1%
Mean	**-5.5%**	**-6.2%**	**-6.6%**	**-4.0%**	**-0.8%**	**-0.1%**	**2.2%**	**2.2%**
Family Dining:								
Bob Evans	-1.6%	-3.0%	-2.8%	-4.2%	-4.1%	-3.5%	-0.9%	-0.5%
Cracker Barrel	-0.9%	-1.4%	0.6%	-0.2%	0.6%	2.0%	2.4%	0.3%
Denny's	-1.1%	-4.2%	-7.2%	-7.0%	-6.2%	-5.9%	-1.1%	-1.4%
Frisch's Big Boy	0.7%	4.6%	-0.1%	-0.4%	-3.4%	-2.7%	-0.8%	-1.1%
IHOP	2.0%	-0.6%	-1.1%	-3.1%	-0.4%	-1.0%	0.1%	1.1%
Luby's	-8.9%	-13.6%	-13.3%	-12.5%	-4.8%	-0.5%	5.5%	2.7%
Ninety Nine	-4.5%	-10.0%	-7.1%	-6.5%	-6.0%	-0.5%	1.2%	1.3%
Perkins	-4.9%	-8.3%	-7.5%	-5.6%	-5.7%	-5.1%	-2.8%	-
Mean	**-2.4%**	**-4.6%**	**-4.8%**	**-4.9%**	**-3.8%**	**-2.2%**	**0.5%**	**0.3%**

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

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

SSS Data (Con't)

	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10
Fast Casual:								
Chipotle	2.2%	1.7%	2.7%	2.0%	1.3%	8.7%	11.4%	12.6%
Cosi	-11.3%	-12.2%	-10.7%	-11.9%	-3.4%	3.1%	6.6%	4.5%
Einstein Noah Bagel	-5.7%	-2.2%	-3.1%	-1.4%	0.1%	-1.1%	0.7%	1.6%
Panera Bread	0.7%	-0.4%	2.8%	5.4%	9.5%	9.9%	6.9%	5.8%
Pei Wei	-2.2%	-0.1%	-0.7%	3.0%	2.2%	3.0%	0.8%	1.3%
Qdoba Mexican Grill	-2.3%	-2.8%	-3.1%	-1.7%	3.1%	4.6%	5.6%	6.4%
Rubio's Restaurants	1.9%	0.9%	-2.7%	-2.7%	-1.8%	-3.3%	-	-
Steak n Shake	2.4%	5.0%	10.1%	14.4%	5.1%	7.5%	3.0%	2.1%
Tim Horton's (US)	3.2%	3.3%	4.3%	2.1%	3.0%	3.1%	3.3%	6.3%
Mean	**-1.2%**	**-0.8%**	**0.0%**	**1.0%**	**2.1%**	**3.9%**	**4.8%**	**5.1%**
QSR:								
Chicken:								
Church's	1.5%	-5.6%	-	-	-	-	-	-
El Pollo Loco	-5.9%	-6.8%	-10.1%	-10.0%	-6.7%	-4.9%	-2.2%	-
KFC	-7.0%	3.0%	-2.0%	-8.0%	-4.0%	-7.0%	-8.0%	1.0%
Pollo Tropical	-3.0%	-3.1%	-0.1%	0.3%	3.7%	6.3%	8.8%	10.7%
Popeyes	-0.3%	4.3%	-0.3%	-1.0%	-0.4%	0.4%	5.3%	6.2%
Mean	**-2.9%**	**-1.6%**	**-3.1%**	**-4.7%**	**-1.9%**	**-1.3%**	**1.0%**	**6.0%**
Coffee/Snack:								
Caribou Coffee	-5.0%	-3.3%	-0.5%	0.2%	5.2%	4.8%	4.4%	3.5%
Jamba Juice	-13.8%	-13.7%	-5.3%	-5.3%	-3.3%	-2.4%	-2.7%	0.2%
Krispy Kreme	2.1%	5.9%	5.1%	1.1%	3.4%	5.7%	5.0%	1.1%
Starbucks	-8.0%	-6.0%	-1.0%	4.0%	7.0%	9.0%	8.0%	8.0%
Mean	**-6.2%**	**-4.3%**	**-0.4%**	**0.0%**	**3.1%**	**4.3%**	**3.7%**	**3.2%**
Mexican:								
Taco Bell	2.0%	1.0%	-2.0%	-5.0%	-2.0%	1.0%	3.0%	4.0%
Mean	**2.0%**	**1.0%**	**-2.0%**	**-5.0%**	**-2.0%**	**1.0%**	**3.0%**	**4.0%**
Pizza:								
Domino's	1.0%	-0.7%	0.0%	1.4%	14.3%	8.8%	11.7%	6.3%
Papa John's	0.3%	0.1%	0.0%	-0.5%	-0.4%	0.4%	-0.6%	0.7%
Pizza Hut	-3.0%	-8.0%	-13.0%	-12.0%	5.0%	8.0%	8.0%	10.0%
Sbarro	-4.8%	-5.1%	-5.2%	-4.6%	-1.6%	-6.2%	-3.5%	-
Mean	**-1.6%**	**-3.4%**	**-4.6%**	**-3.9%**	**4.3%**	**2.8%**	**3.9%**	**5.7%**
Sandwich:								
Arby's	-8.7%	-6.9%	-9.0%	-11.0%	-11.5%	-7.4%	-5.9%	2.0%
Burger King	1.6%	-4.5%	-4.6%	-3.3%	-6.1%	-1.5%	-4.2%	-5.8%
Carl's Jr.	-5.1%	-6.1%	-5.2%	-8.7%	-6.4%	-7.4%	-5.0%	-0.4%
Hardee's	2.5%	-2.7%	-1.8%	-2.5%	-1.8%	6.8%	8.3%	5.7%
Jack in the Box	0.4%	-1.0%	-6.0%	-11.1%	-8.6%	-9.4%	-4.0%	1.5%
McDonald's	4.7%	3.5%	2.5%	0.1%	1.5%	3.7%	5.3%	4.4%
Sonic Drive-In	-3.6%	-5.4%	-4.5%	-6.5%	-13.2%	-6.0%	-6.4%	-2.4%
Wendy's	1.0%	-0.4%	-0.1%	-3.0%	0.8%	-1.7%	-1.7%	0.2%
Mean	**-0.9%**	**-2.9%**	**-3.6%**	**-5.8%**	**-5.7%**	**-2.9%**	**-1.7%**	**0.7%**
Mean Total QSR	**-2.3%**	**-2.8%**	**-3.0%**	**-4.1%**	**-1.2%**	**0.0%**	**1.1%**	**3.0%**

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

Motor Fuels Looming Impact On Restaurant Sales

We believe that the Federal Reserve's policy of monetizing our debt through quantitative easing will continue to exacerbate the decline in the value of the US dollar relative to other currencies. Other than a change in policy, the only thing that can stop this is a major military conflict or a global pandemic. If this continues, gasoline prices (and other commodity prices for that matter) will continue to rise at the gas pump for US consumers. This will take cars off the road which will eventually undermine traffic at major US restaurant chains. We believe the harm will be universal, but much more destructive to second and third tier restaurant concepts.

A little background about oil consumption may be helpful to properly understand the current gasoline and diesel fuel price escalations. The United States consumes 20 million barrels of oil each day or approximately 25% of worldwide total in spite of the fact that the US has only 4% of he world population. Approximately 12 million of those barrels are imported and 8 million are domestically produced. These numbers are getting better in terms of the US quotient of production, but will still remain ugly for years to come. According to the US Department of Energy, we will be importing oil in substantial quantities for the next 20 years at a minimum.

The US drives approximately 3.5 trillion miles per year which consumes 14 million barrels of gasoline and diesel fuel on our nation's highways each day. This represents nearly 70% of US oil consumption. We are starting to drive less and consume less fuel which is a good start, but we still consume way too much fuel. For instance, annual US consumption of gasoline gallons per person is approximately 6,118 as compared to 1,500 in Great Britain, 806 in Spain, 845 in France and 1,337 in Germany. We simply consume too much of a share of the world's oil supply and this will keep gasoline prices high especially in conjunction with a sharply falling dollar. Long-term, this is not good for restaurant traffic.

Economists argue that the real price of gasoline in the United States is in the neighborhood of $10 a gallon because of the enormous defense expenditures put forth by the US military to keep a lid on the Middle East and keep shipping lanes open and free of pirates and terrorists. But having said that, gasoline prices in the European nations alliterated above average approximately $6.50 per gallon compared to a US average of $3.47 per gallon. Cheap gasoline has become the Holy Grail of Congress and the US oil industry. This has enabled many businesses such as quick service restaurants to thrive on the backs of cheap gasoline. We expect that the halcyon days of this cheap gasoline will steadily come to an end based on consumption trends in emerging markets, the decline of the US dollar and political instability in many key oil-producing regions such as the Middle East, Russia and Venezuela.

We believe that restaurants of all types suffer when high gasoline prices take cars off the road. Some economists say there's been a decoupling between restaurant sales and gasoline prices. We strongly disagree. We believe that the $147 per barrel oil prices experienced in 2008 were exacerbated by tight refinery supplies, higher global consumption and significant hedge fund speculation. During this time gasoline rose to a high of approximately $4.10 per gallon, but retreated to approximately $2.50 by Thanksgiving. The difference now, 27 months later, is that we have a more efficient rolling stock of automobiles on the highway and we drive much less. So now there's less leeway for consumers to reduce consumption trends as prices increase. In other words, we believe the consumer has already substantially cut superfluous driving miles and high gasoline prices will continue to significantly reduce restaurant traffic, especially in weaker concepts. Unfortunately, we expect $5.00 per gallon gas prices by December 2011.

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

Defensive Reinvestment:
This old idea is relevant

Maintaining value with a restaurant company is all about reinvestment. However, the capital dynamic of the industry has changed, perhaps permanently. Five or ten years ago, a remodel, purchase of new sign, menu board was done with a resulting boost in sales, boost in cash flow and an IRR proposition with which your local Charles Schwab broker had difficulty competing. However today, that high return reinvestment proposition is becoming more brand and location dependent.

For those restaurant companies who understand today's environment, everything from a simple paint/seal/stripe all the way to a successor scrape and re-build have largely morphed into defensive spending strategies. This spending is correctly viewed by savvy restaurant execs as an investment in maintaining, not necessarily augmenting, the valuation of the corresponding asset.

This defensive shift has taken place because of a stagnant pool of consumer dollars, a reemergence of competition from new entrants of both conventional and breakthrough food propositions (Panera, Chipotle, etc.) and a predatory capex strategy by today's leading chains against their lesser competition.

In an environment like this, restaurant operators have to understand that business as usual will result in declining sales; without the addition of a new variable to an equation involving flat consumer pool and more competition . . . it's just math. However, in an industry where so many companies are capital constrained and the consumer must increasingly be wooed away from the dollar bill in their pockets, there is opportunity beyond excelling in customer service and product innovation (see our last piece on fighting the commodity trends).

McDonald's for instance, gets it. When one of their regional managers walks into a competing burger or QSR joint to see cracked tiles or faded paint, he/she realizes that there is an opportunity. McDonalds will pour hundreds of thousands of dollars into their nearest location (stacked stone facade, flat screen TVs and all other new and earthtone fixtures). They understand that they can grow market share in this tough environment because their competition is struggling financially and unable to maintain curb appeal.

In any competitive consumer environment, it's all about choice: why would a consumer pay the same price at a dilapidated competitor when a newly remodeled or built option serves a similar product? For a better quality of food? For better pricing, product and promotion ("PPP")? . . . Ridiculous! Old run down facilities feel dirty, unsanitary and have no curb appeal - - PPP and food quality usually loose to curb appeal in the long run. Therefore, restaurant owners need to view reinvestment as requisite to defending the value of today's business.

Defensive reinvestment, feels like a recent phenomenon given last decades of growth and relative easy money – but it's not a new concept. We forget that depreciation, as an accounting convention, used to require sequestering funds from operations in a restricted cash account dedicated to capex. The restricted cash could not be accessed except for re-investment in the facility. This was a rule to address the fact that the value of any business usually degenerates over time with its assets.

Consider two restaurants of the same concept. The first has been in operation for 18 years, needs new equipment, and is approaching the term end of its franchise agreement with significant remodel requirements in order to renew. The second has just been built in a similar demographic, similar traffic area and performs similarly from a financial perspective. It's equipment is new and there is no significant remodel requirement for the next 8 years. If both restaurants generate $85,000 of EBITDA in the same geography and same brand, are they both worth 5 or 6 times? Absolutely not.

EBITDA, as a sale valuation rubric, therefore is a myth in the restaurant business. As long as the "D" remains in its definition with no cash reserve, EBITDA is not a valid baseline metric for asset valuation in our industry. Rather, that non-existent reserve for asset remodels and other capital requirement will be applied to the final price in any asset sale. Someone's got to pay for it – and if the owner of the first location thinks he can sell his business for the same value of restaurant number two, he's either found some sublimely "dumb money", or he is going to be sorely disappointed when the buyer inevitably re-trades in order to account for the unanswered capital requirements of the assets.

Buyers today are too sophisticated to miss this point. Businesses must be capable of maintaining customer traffic if a buyer is going to pay a reasonable valuation to acquire them. But those businesses also have to meet the terms of related franchise agreements, and franchisors today are keenly aware of the strategy employed by McDonalds and other growing, predatory competitors. Maintaining the value of your business therefore is critically impacted by your capital spending strategy. Defensive re-investment therefore must be part of every business owners' vernacular.

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Trinity Capital is an active participant, sponsor and speaker at numerous industry conferences. Upcoming events include:

April 2011 - Trinity Capital is a conference sponsor and exhibitor at the *15th Annual UCLA Extension Restaurant Industry Conference*. The 2011 Conference will be held on April 21st at the Century Plaza Hotel in Los Angeles. Kevin Burke will participate in a finance panel discussion. If you are attending and would like to make arrangements for an on-site meeting please call Jennifer Brown at 310.231.3113 to schedule a time.