TRINITY CAPITAL
INVESTMENT BANKING

Restaurant Industry Commentary
&
4th Quarter 2014 SSS

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Same-Store Sales Discussion and Analysis

During the fourth quarter of 2014 ("Q4 2014"), the restaurant industry maintained positive momentum in same-store sales, with an increase of 4.4%; that marks the 19th consecutive quarter of industry-wide same-store sales gains. The Q4 2014 results were boosted by relatively temperate weather conditions in November and December of 2014, in stark contrast to what the greater part of the country experienced in 2013. In addition, in Q4 2014 the fine dining, family dining and casual dining segments returned to their respective pre-recession levels (see cumulative same-store sales graph).

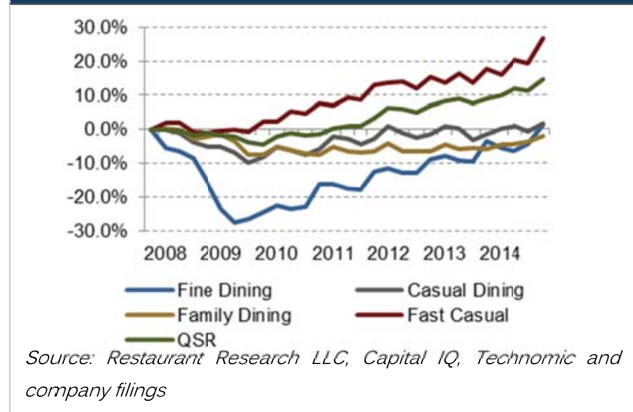
In fine dining, the companies we monitor were up by an average of 5.0% year-over-year in Q4 2014. Although this segment has had 20 consecutive positive quarters, fine dining sales are just returning to pre-recession levels. This slow recovery has been problematic for operators due in part to the significant cost increases that occurred over the previous seven years, placing downward pressure on the cash flows of fine dining operators. Going forward, managers must continue to be mindful of the bottom line, as recent increases in sales may have not been substantial enough to offset rising costs.

In the casual dining segment, the concepts we follow were up year-over-year by an average of 2.9% for Q4 2014, the third consecutive quarter with positive same-store sales results. According to Knapp-Track, casual dining guest counts decreased 0.2% and 1.6% in October and November, respectively, and increased 0.3% in December. Knapp-Track has reported negative casual dining guest counts in 62 of the last 72 months. With that said, we expect to observe a shift to positive guest count numbers in the coming months, as the segment comps over nearly six years of negative numbers and motor fuel prices remain low. The family dining concepts we track reported an average year-over-year increase in same-store sales of 4.0% during Q4 2014.

The fast casual segment continued its positive momentum with its 21st consecutive quarter of positive comps, posting year-over-year growth of 7.7% for Q4 2014. This high growth segment continues to produce exceptional same-store sales results, despite comping over more than five years of strong growth.

In the QSR segment, year-over-year same-store sales growth for 16 of the 18 concepts we track was positive during Q4 2014. The segment was up an average of 5.3%. The chicken QSR segment enjoyed another strong quarter, with a year-over-year increase of 8.1%. Popeye's (up 10.7%) led the way, followed by Pollo Tropical (up 7.7%) and KFC (up 6.0%).

Cumulative Same-Store Sales Change by Segment



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

2014 ended on a high note for same-store sales growth in the restaurant industry. According to Black Box Intelligence's Restaurant Industry Snapshot, which is based on weekly sales from over 20,000 restaurant units, the industry recorded same-store sales at a three year high in the month of December and Q4 2014 registered the best results in the last six years.

Unfortunately, the rough weather experienced by much of the U.S. in Q4 2013 returned and hit a large portion of the country in Q1 2015, leading to our expectation of softer results for early 2015. However, the cheap gas and economic momentum should offset some of the weather issues and improve industry same-store sales in the coming periods.

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

Same-Store Sales ("SSS") Data

	FY 2012				FY 2013				FY 2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Fine Dining												
Fleming's	5.4%	6.8%	10.1%	4.0%	5.4%	2.0%	4.2%	4.9%	1.7%	3.6%	4.8%	3.4%
Ruth's Chris	3.7%	6.0%	5.9%	5.4%	6.6%	4.6%	4.2%	5.5%	2.6%	2.8%	4.8%	5.0%
Capital Grille	5.7%	2.8%	4.0%	2.3%	3.0%	4.5%	3.2%	6.7%	0.1%	0.8%	3.9%	6.1%
Del Frisco's	7.9%	7.3%	5.3%	5.9%	1.9%	5.9%	4.4%	5.2%	5.1%	5.2%	8.4%	5.5%
Mean	**5.7%**	**5.7%**	**6.3%**	**4.4%**	**4.2%**	**4.3%**	**4.0%**	**5.6%**	**2.4%**	**3.1%**	**5.5%**	**5.0%**
Casual Dining												
Applebee's	1.2%	0.4%	2.0%	0.9%	(1.3%)	1.3%	(0.4%)	(0.3%)	(0.5%)	0.6%	1.7%	2.8%
BJ's Restaurants	3.3%	4.4%	2.3%	3.0%	(0.4%)	0.0%	(2.2%)	(2.7%)	(2.9%)	(1.7%)	0.3%	1.2%
Bonefish	6.2%	2.1%	3.5%	1.0%	0.5%	0.2%	(2.7%)	0.9%	(1.5%)	0.3%	2.6%	0.7%
Buffalo Wild Wings	8.1%	5.4%	6.0%	6.7%	1.9%	4.0%	4.3%	4.0%	5.7%	7.0%	5.8%	5.5%
Carrabba's Italian Grill	4.3%	1.5%	1.0%	(0.4%)	(1.7%)	0.3%	0.0%	0.9%	(1.8%)	(1.2%)	(1.2%)	0.3%
Cheesecake Factory	2.6%	2.1%	2.9%	1.3%	1.6%	0.9%	1.0%	1.1%	1.2%	1.5%	2.1%	1.4%
Chili's Grill & Bar	4.6%	2.2%	2.8%	1.0%	(1.1%)	(0.6%)	(1.9%)	0.2%	0.5%	2.5%	2.3%	4.2%
Dave & Buster's	(0.3%)	5.4%	5.4%	3.7%	1.8%	(0.9%)	(0.9%)	2.4%	0.7%	4.7%	8.7%	10.5%
Famous Dave's	(1.6%)	(0.6%)	0.2%	(6.0%)	(1.8%)	3.8%	(2.3%)	(1.1%)	(3.3%)	(2.8%)	(2.3%)	(4.0%)
Granite City	1.9%	1.5%	2.5%	4.5%	2.7%	2.5%	0.4%	0.6%	N/A	N/A	N/A	0.7%
LongHorn Steakhouse	3.8%	3.0%	2.2%	(0.8%)	(1.6%)	3.5%	3.2%	2.9%	0.3%	2.4%	2.8%	2.6%
Maggiano's	3.9%	1.9%	0.9%	0.6%	0.4%	0.2%	0.6%	0.9%	0.2%	0.9%	0.6%	2.3%
Olive Garden	2.0%	(1.8%)	0.3%	(3.2%)	(4.1%)	1.1%	(4.0%)	(0.6%)	(5.4%)	(4.2%)	(1.3%)	2.2%
Outback	5.3%	2.3%	4.5%	5.3%	2.5%	2.8%	(0.3%)	1.1%	0.8%	0.9%	4.8%	6.4%
Red Lobster	6.0%	(3.9%)	(2.6%)	(2.7%)	(6.6%)	3.2%	(5.2%)	(4.5%)	(8.8%)	(5.6%)	N/A	N/A
Red Robin	1.0%	1.2%	0.6%	1.4%	1.4%	3.6%	5.4%	3.7%	5.8%	1.6%	1.4%	4.3%
Ruby Tuesday	(5.0%)	(4.6%)	1.9%	0.3%	(2.8%)	(3.1%)	(11.4%)	(7.8%)	(1.9%)	0.4%	1.1%	(1.0%)
Taco Cabana	6.1%	4.5%	1.8%	6.8%	2.0%	1.1%	1.8%	(2.9%)	0.8%	2.8%	3.5%	6.1%
Texas Roadhouse	6.2%	4.6%	3.9%	4.5%	3.7%	4.7%	2.9%	2.5%	3.0%	3.0%	5.8%	6.8%
Mean	**3.1%**	**1.7%**	**2.2%**	**1.5%**	**(0.2%)**	**1.5%**	**(0.6%)**	**0.1%**	**(0.4%)**	**0.7%**	**2.3%**	**2.9%**
Family Dining												
Bob Evans	(0.6%)	1.0%	1.0%	1.6%	0.0%	(0.6%)	(1.9%)	(1.8%)	(4.1%)	(2.0%)	0.0%	3.8%
Denny's	2.4%	0.8%	0.4%	1.7%	(0.7%)	0.6%	1.2%	0.9%	1.8%	1.9%	2.4%	4.7%
Frisch's Big Boy	1.7%	(1.7%)	(0.2%)	(1.7%)	(0.9%)	1.0%	(0.1%)	0.0%	(3.6%)	0.7%	1.8%	4.8%
IHOP	(0.5%)	(1.4%)	(2.0%)	(2.6%)	(0.5%)	1.9%	3.6%	4.5%	3.9%	3.2%	2.4%	6.1%
Luby's	2.2%	1.1%	2.4%	0.2%	(0.1%)	1.0%	2.4%	1.2%	2.2%	4.4%	1.4%	0.7%
Mean	**1.0%**	**(0.0%)**	**0.3%**	**(0.2%)**	**(0.4%)**	**0.8%**	**1.0%**	**1.0%**	**0.0%**	**1.6%**	**1.6%**	**4.0%**

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

SSS Data (Cont'd)

	FY 2012				FY 2013				FY 2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Fast Casual												
Chipotle	12.7%	10.2%	4.8%	3.8%	1.0%	5.5%	6.2%	9.3%	13.4%	17.3%	19.8%	16.1%
Cosi	7.5%	(0.5%)	(0.7%)	(3.9%)	(4.5%)	(2.7%)	(3.6%)	(4.6%)	(9.5%)	(4.7%)	(1.9%)	3.9%
Einstein Noah Bagel	1.1%	1.3%	0.2%	1.4%	(0.6%)	0.7%	(1.4%)	0.1%	1.6%	1.6%	1.6%	N/A
Noodles & Company	6.8%	6.8%	3.4%	4.2%	2.2%	4.7%	2.1%	3.9%	(1.6%)	0.2%	1.7%	1.3%
Panera Bread	6.3%	5.9%	5.8%	4.9%	3.3%	3.7%	1.3%	1.1%	0.1%	0.1%	1.4%	3.0%
Qdoba Mexican Grill	3.0%	2.1%	3.3%	1.0%	(1.5%)	1.3%	2.0%	2.3%	7.0%	7.5%	7.7%	14.0%
Steak n Shake	5.5%	4.8%	2.9%	3.8%	1.3%	0.3%	4.2%	2.2%	3.0%	3.7%	N/A	N/A
Mean	**6.1%**	**4.4%**	**2.8%**	**2.2%**	**0.2%**	**1.9%**	**1.5%**	**2.0%**	**2.0%**	**3.7%**	**5.1%**	**7.7%**
QSR												
Chicken												
KFC	2.0%	1.0%	4.0%	4.0%	4.5%	3.0%	(4.0%)	(5.0%)	(3.0%)	(2.0%)	2.0%	6.0%
Pollo Tropical	9.4%	7.8%	7.0%	8.3%	3.8%	6.4%	6.5%	7.0%	6.3%	6.7%	5.9%	7.7%
Popeye's	8.1%	8.4%	6.8%	6.4%	0.5%	4.3%	5.1%	0.3%	4.3%	3.8%	7.2%	10.7%
Mean	**6.5%**	**5.7%**	**5.9%**	**6.2%**	**2.9%**	**4.6%**	**2.5%**	**0.8%**	**2.5%**	**2.8%**	**5.0%**	**8.1%**
Coffee/Snack												
Baskin Robbins	9.4%	4.6%	1.1%	1.5%	(4.4%)	1.6%	4.2%	2.2%	0.5%	4.2%	5.8%	9.3%
Dunkin Donuts	7.2%	4.0%	4.0%	3.2%	1.7%	4.0%	4.2%	3.5%	1.2%	1.8%	2.0%	1.4%
Jamba Juice	12.7%	5.7%	2.5%	0.6%	1.3%	1.7%	(3.4%)	0.3%	0.6%	2.5%	3.7%	4.9%
Krispy Kreme	2.1%	5.4%	6.8%	7.5%	11.4%	10.0%	3.7%	1.6%	3.3%	2.3%	3.7%	6.7%
Starbucks	8.0%	7.0%	7.0%	7.0%	7.0%	9.0%	8.0%	5.0%	6.0%	6.0%	5.0%	5.0%
Tim Horton's	8.5%	4.9%	2.3%	3.2%	(0.5%)	1.4%	3.0%	3.1%	1.9%	5.9%	6.8%	4.1%
Mean	**8.0%**	**5.3%**	**4.0%**	**3.8%**	**2.8%**	**4.6%**	**3.3%**	**2.6%**	**2.3%**	**3.8%**	**4.5%**	**5.2%**
Mexican												
Taco Bell	6.0%	13.0%	7.0%	5.0%	6.0%	2.0%	2.0%	1.0%	(1.0%)	2.0%	3.0%	7.0%
Mean	**6.0%**	**13.0%**	**7.0%**	**5.0%**	**6.0%**	**2.0%**	**2.0%**	**1.0%**	**(1.0%)**	**2.0%**	**3.0%**	**7.0%**
Pizza												
Domino's	2.0%	1.7%	3.3%	4.7%	6.2%	6.7%	5.4%	3.7%	4.9%	5.4%	7.7%	11.1%
Papa John's	1.1%	5.7%	2.5%	5.2%	1.6%	3.4%	1.8%	6.6%	9.6%	6.0%	7.4%	4.1%
Pizza Hut	5.0%	4.0%	6.0%	(1.0%)	(1.0%)	(2.0%)	(1.0%)	(4.0%)	(5.0%)	(4.0%)	(2.0%)	0.0%
Mean	**2.7%**	**3.8%**	**3.9%**	**3.0%**	**2.3%**	**2.7%**	**2.1%**	**2.1%**	**3.2%**	**2.5%**	**4.4%**	**5.1%**
Sandwich												
Burger King	4.2%	4.4%	1.6%	3.7%	(3.0%)	(0.5%)	(0.3%)	0.2%	0.1%	0.4%	3.6%	4.2%
Jack in the Box	5.6%	3.4%	3.1%	1.9%	0.1%	0.1%	(1.4%)	1.9%	0.7%	2.4%	3.1%	4.4%
McDonald's	8.9%	3.6%	1.2%	0.3%	(1.2%)	1.0%	0.7%	(1.4%)	(1.7%)	(1.5%)	(3.3%)	(1.7%)
Sonic Drive-In	3.5%	2.8%	2.3%	3.0%	1.3%	0.1%	5.9%	2.2%	1.4%	5.3%	3.5%	8.5%
Wendy's	0.7%	3.2%	2.8%	(0.5%)	0.7%	0.3%	3.1%	2.9%	0.7%	3.2%	0.8%	1.7%
Mean	**4.6%**	**3.5%**	**2.2%**	**1.7%**	**(0.4%)**	**0.2%**	**1.6%**	**1.2%**	**0.2%**	**2.0%**	**1.5%**	**3.4%**
Mean Total QSR	**5.8%**	**5.0%**	**4.0%**	**3.6%**	**2.0%**	**2.9%**	**2.4%**	**1.7%**	**1.7%**	**2.8%**	**3.7%**	**5.3%**

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

Status and Implications of Sysco – US Foods Merger

In December of 2013, Sysco and US Foods made the blockbuster announcement that the companies intend to merge in an $8.2 billion transaction that would create a true goliath in foodservice distribution. By combining the number one and two players in the industry, the companies would represent 25% of foodservice distribution and a 75% market share of the national "broadline" market. While Sysco and US Foods argue that the greater scale of operations would result in more efficiencies and better prices for customers, a number of restaurant chains and government officials shudder at the potential for fewer choices, higher costs and worse service.

FTC Resistance – During the ensuing 14 months, the transaction has been scrutinized by the Federal Trade Commission, which is concerned that there will not be another significant national player once the deal is consummated. Sysco has pointed out that there are numerous regional and local distributors to whom the customers have access. Furthermore, Sysco has proposed to sell 11 of US Foods' distribution centers ("DCs") to Performance Food Group ("PFG"), the number 3 player. PFG would have a combined 35 DCs at that point, which is about one-third the size of the Sysco-US Foods DC footprint. The 11 DCs are mainly in the West where PFG has a limited presence, and would create a legitimate national competitor.

As negotiations with the FTC stalled, Sysco appealed directly to the five politically appointed FTC Commissioners. Sysco's efforts prompted the Commission to initially postpone any action on the merger, but, in February of this year, the Commissioners voted to sue to block the transaction, indicating the combination would hurt customers and reduce competition, particularly in 32 local markets. The FTC vote fell along party lines with three Democrats voting in favor of the suit, and two Republicans voting against. With the vote, the FTC staff was authorized to seek a temporary restraining order and a preliminary injunction to prevent the merger. The FTC's statement included, "This proposed merger would eliminate significant competitors…and creates a dominant national broadline foodservice distributor. Consumers…benefit from the healthy competition between Sysco and US Foods, whether they eat at a restaurant, hotel or hospital."

In response to the FTC vote, Sysco stated: "This industry…is fiercely competitive. Customers…have access to foodservice distribution services from a variety of companies and any number of channels. In fact, the overwhelming majority of restaurants and food operators choose their foodservice locally, where they have choices among many excellent companies."

Legal Status – The Wall Street Journal reported that Sysco has hired a leading antitrust law firm that successfully negotiated a settlement with the Justice Department on the US Airways-American Airlines merger. There is no telling how the Sysco-US Foods lawsuit will play out and, if settled, what concessions or compromises the companies will need to make. As of now, the FTC does not believe the enlarged PFG (following the purchase of the 11 US Foods DCs) would be enough of a national broadline competitor to offset the damage done by the merger.

While Sysco has argued that even national restaurant chains use regional distributors and there is substantial competition on a local level, a number of state attorneys general have joined the FTC in the lawsuit.

Court hearings on the FTC injunction are to begin on May 5. The FTC administrative trial is scheduled to start on July 21.

Implications and Opportunities – A number of restaurant companies, hotel chains and purchasing groups have expressed concerns about the potential consolidation of Sysco and US Foods. In many cases, our restaurant clients have already begun to seek alternative supply avenues. The regional and specialty foodservice distributors whom we talk with have indicated that they have seen a pick-up in business and are optimistic about the opportunities the mega-merger is creating for them. These suppliers believe they can compete very effectively against the industry giants through better service, more unique product offerings, greater tailoring of customer solutions and enhanced access to local producers. Many of the specialty distributors have added other product lines in an effort to become a more complete solution for restaurant customers. At the same time, restaurant operators are looking for improved service and more timely delivery and are trying to address their customers' interest in locally sourced protein, produce and other food items. There will always be large chains in need of national broadline services, but increasingly the regional/specialty distributor is a viable alternative for most restaurant groups.

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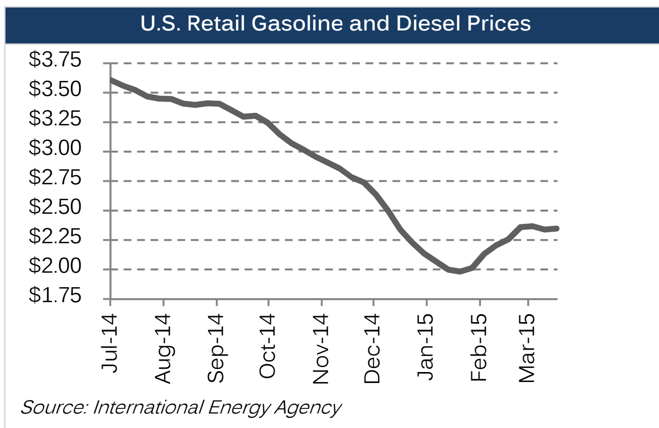
Lower Fuel Prices Lead to Higher Restaurant Sales and Profitability

The recent bad news for energy companies is translating into good news for restaurant companies. As the oil supply grew faster than demand in the last two quarters, the price of oil steadily declined. Generally, lower oil prices lead to lower gasoline prices at the pump, which translates to drivers spending less money to fill up their tanks and keeping more money in their pockets. We call that extra money in drivers' (or consumers') pockets, the "gas dividend." Consumers may use the gas dividend to 1) increase their savings, 2) pay down debt and/or 3) spend money on other goods and services. It can be difficult to determine the exact portion of the gas dividend that is allocated to each of those three buckets, but recent data suggests a significant amount is being spent at restaurants. Lower fuel prices are not only boosting restaurant sales, they are also reducing pricing pressure on the cost of goods sold at restaurants, leading to margin improvements.

As the chart below illustrates, since the middle of 2014, U.S. retail gasoline and diesel prices have declined by more than 35%.[1] The average driver in the U.S. drives approximately 13,500 miles per year.[2] If we conservatively assume the average car gets 20 miles per gallon, then the 35% decrease in gas prices results in a gas dividend of roughly $875 per driver per year. That is a meaningful increase to the average household's disposable income, particularly if there is more than one driver in a household.



Source: International Energy Agency

[1] U.S. Energy Information Administration

[2] U.S. Department of Transportation Federal Highway Administration

To those of us that are continuously analyzing restaurant data by segment, region and concept, the improvement in casual dining same-store sales ("SSS") has been particularly noticeable over the last seven months. Beginning in January 2013, the casual dining segment experienced positive same-store sales growth in just 4 of the 19 subsequent months, and guest traffic growth was positive in only two months. Yet, the segment has enjoyed seven consecutive months of positive same-store sales growth and three months of guest traffic growth since August 2014.[3] It seems intuitive that as disposable income for U.S. consumers increases, they are likely to dine out more often, spend a bit more on a typical meal, or possibly both. However, let us peel back the onion a bit more and look at this analysis on a regional level.

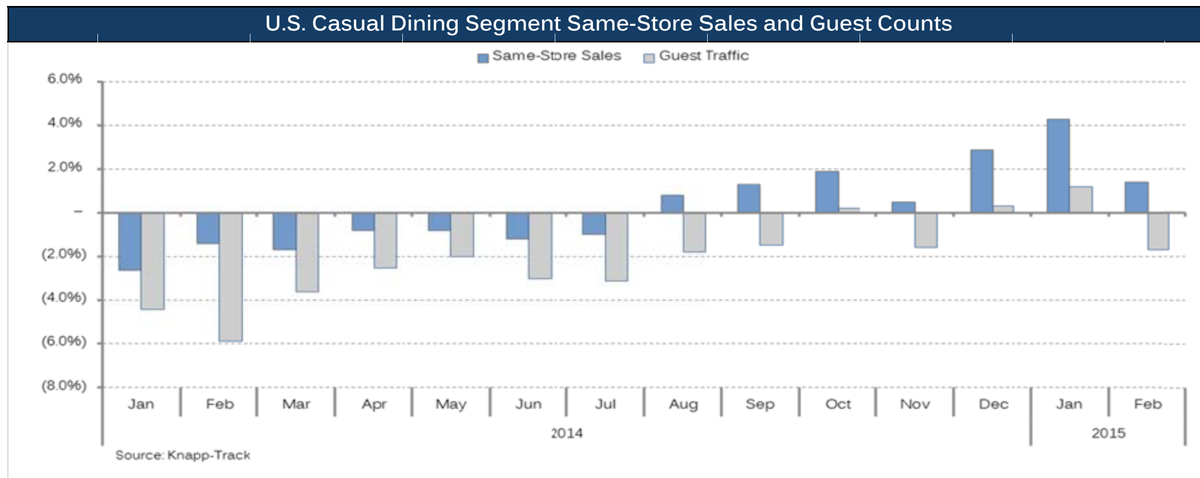
Weather conditions, especially during the winter months, have a tremendous impact on consumer activity in certain regions across the country. In situations of heavy precipitation and hazardous road conditions, consumers are far more likely to stay off the roads, and, in many cases, inclement weather forces schools and businesses to close. With fewer trips to the drive-thru on the commute to or from school, fewer lunch meetings out of the office and fewer family meals away from home during the weekend, restaurant sales in certain regions are clearly subject to weather related disruptions. This can overshadow the ability of gasoline price decreases to generate positive traffic in restaurants.

Last year, the Midwest experienced one of the top ten coldest seasons in its history, and Detroit had its snowiest winter on record. This year, the Southeast and Northeast were hit by a Category 3 storm that brought heavy snow and ice, giving Boston its snowiest winter on record.[4] As a result, this year the Midwest is showing very strong year-over-year sales growth and the Southeast and Northeast are showing slightly weaker year-over-year sales growth; these extreme weather variations make it very difficult to identify non-weather related economic trends.

In order to limit the impact weather has on restaurant performance in certain regions of the country from one year to another, our analysis focuses on the 11 westernmost states in the U.S. (excluding Alaska and Hawaii).

[3] Knapp-Track

[4] National Climatic Data Center – National Oceanic And Atmospheric Administration



Outside of a few mountain resorts and small rural towns, the West has fairly mild and consistent weather patterns.

With that said, let us then compare restaurant same-store sales and then compare restaurant same-store sales in the West to U.S. gross domestic product ("GDP") growth since October 2014.

For the fourth quarter of 2014, U.S. GDP growth was 2.2%.[5] The Capital Spectator's median forecast and The Wall Street Journal's March survey-based estimate of first quarter 2015 GDP growth are 2.1% and 2.3%, respectively. For the purpose of this analysis, we will reasonably assume the average GDP growth rate is 2.2% for each month within these two quarters. As shown in the table below, QSR same-store sales in the 11 westernmost states have meaningfully outperformed U.S. GDP growth, especially on a cumulative basis, over the last five months. In particular, the casual dining segment has shown exceptional growth

U.S. GDP vs Western U.S. Restaurant SSS

Month	U.S. GDP Growth	Western U.S. Casual Dining SSS Growth	Western U.S. QSR SSS Growth
Oct-14	2.2%	2.0%	1.9%
Nov-14	2.2%	2.7%	2.5%
Dec-14	2.2%	5.0%	3.6%
Jan-15	2.2%	6.1%	2.0%
Feb-15	2.2%	3.6%	3.8%

Source: U.S. Bureau of Economic Analysis, MillerPulse

[5] U.S. Bureau of Economic Analysis

It is also interesting to note that the gas dividend is likely to influence certain demographics and generations in different ways. Millennials currently have a negative 2.0% savings rate[6] and, among all generations, commit the largest portion of their food expenditures to food away from home.[7] With the gas dividend, Millennials are less likely to increase the frequency of their meals away from home since they seldom eat at home to begin with; instead they are more likely to increase their average check size, a trend more evident at fast casual and QSR concepts that tend to attract a bigger portion of Millennials than other segments. On the contrary, Baby Boomers have a positive 13.0% savings rate[8] and commit a smaller portion of their food expenditures to food away from home relative to other generations. With the gas dividend, Baby Boomers are more likely to increase the frequency of meals away from home. This trend, which is largely responsible for the recent rebound in casual dining sales, is more evident at casual dining and family dining concepts that tend to attract a greater proportion of Baby Boomers than other segments. The impact of the gas dividend on Generation-X would likely fall somewhere between Millennials and Baby Boomers.

In addition to the recent improved top-line, lower gas and diesel prices are reducing pressure on the cost of goods sold at restaurants, as a great deal of fuel is required to transport food from its source at farms, the ocean and abroad. In fact,

[6] Moody's Analytics

[7] The Food Institute's "Demographics of Consumer Food Spending: 2012"

[8] Moody's Analytics

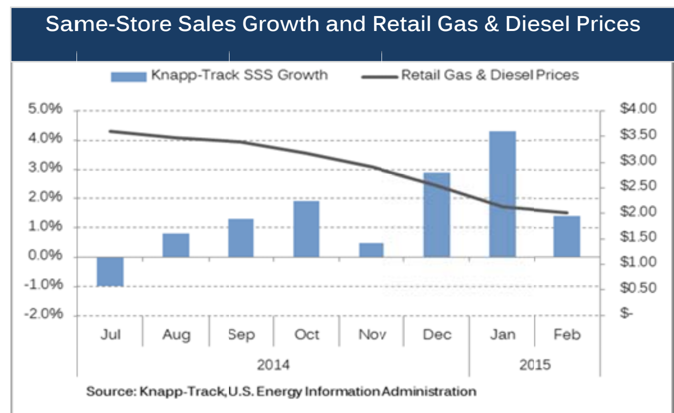
diesel is the single largest expense for the fishing industry,[9] so while restaurant chains like Red Lobster, McCormick & Schmick's and Long John Silver's have many other food cost variables, the lower fuel prices should present a great opportunity for higher gross margins.

Another issue frequently overlooked by industry pundits is the tremendous variation in motor fuel expenses per household in various regions of the country. In large metropolitan areas where there is a high dependency on mass transportation, lower gas prices will provide very little additional restaurant revenues from urban residents that do not frequently use an automobile. On the other hand, suburban residents have seen significant declines in gasoline prices, as much as $1.50 per gallon in high-priced gasoline markets such as California, Nevada, Washington and New York.

An equally important part of the restaurant sales equation to consider is that while gasoline prices can vary substantially between markets, there are also meaningful variations in household income across different geographic markets. The gasoline dividend is a function of how much gas prices have declined in your market, how much you drive and the magnitude of this in relation to your disposable income. Clearly, there are significant variations in household income between states such as Massachusetts and Louisiana and significant variations in the impact that a reduction in gas prices has on restaurant revenues in each of these states. In high income-markets with moderate fuel prices, the gasoline dividend will likely be less helpful to restaurant sales than in modest income, high-priced gasoline markets with above average daily commuting mileage. The bottom line is that restaurant sales have been positively impacted by lower gasoline prices, although this varies by region.

Many of our clients have asked us what could happen that would change the ongoing influence of low gasoline prices on restaurant sales. The short answer is that geopolitical conflict and terrorism act as the primary risks to the continuation of low gasoline prices, with the secondary risk being economic deterioration. Any geopolitical disturbances through terrorism or regional military conflict, particularly in the Persian Gulf where 40% of the world oil population is centered, could send crude oil prices well above $100 per barrel inside a handful of trading sessions, wiping out the savings brought by the recent gasoline price declines. Examples of events that could bring changes of this magnitude would be a conflict between Israel and Iran; conflict between North Korea and any of its neighbors and escalation of the existing conflict between Russia and Ukraine. The U.S. economy has been somewhat immune to the recent global economic deterioration, but if the U.S. economy softens that could overwhelm the benefit of cheaper gasoline prices and cause restaurant traffic to decline. While it is somewhat difficult to isolate certain variables or determine causality in an analysis such as this, we believe a case can clearly be made for the gas dividend contributing to higher restaurant sales in recent months. In the graph below, it is apparent that there has been a positive correlation between the decline in gas prices and increased restaurant sales.

Same-Store Sales Growth and Retail Gas & Diesel Prices



Source: Knapp-Track, U.S. Energy Information Administration

As consumers spend less at the pump, they have more disposable income to spend on other goods and services. Given the strong restaurant same-store sales performance in recent months, particularly in the casual dining segment, it appears consumers are dining out a little more frequently, ordering more per meal and/or opting for higher priced items on the menu. As a result, we believe continued low gas prices should bode well for both the restaurant industry's sales and gross margins going forward.

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[9] American Association for the Advancement of Science