TRINITY CAPITAL
INVESTMENT BANKING

Restaurant Industry Commentary
&
Q3 2018 SSS Update

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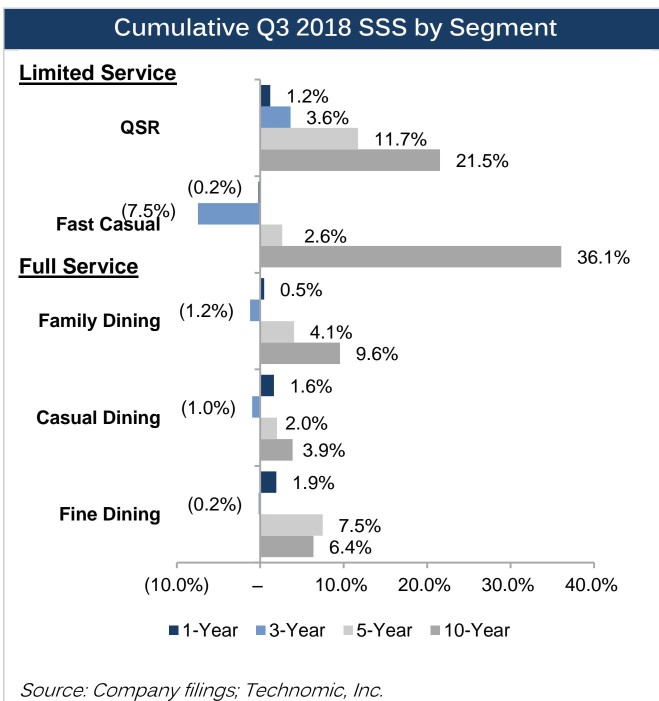
Same-Store Sales Discussion

Restaurant industry same-store sales ("SSS") increased for the fourth consecutive quarter in Q3 2018 following six straight quarters of SSS declines. Of the 57 companies we follow, 40, or 70%, generated SSS growth – an increase of 25% over Q3 2017.

As shown in the figure below, longer term performance remains most consistent in QSR measured over 3, 5 and 10 year periods. Fast casual provided the most growth over the past 10 years, but most of that growth occurred more than five years ago. Casual dining and fine dining have suffered the most, with minimal SSS growth for all time periods over the past 10 years, as diners started flocking to fast casual restaurants.

Cumulative Q3 2018 SSS by Segment



Source: Company filings; Technomic, Inc.

QSR: The QSR segment extended its streak of positive year-over-year ("YOY") SSS growth to six quarters with a 1.2% increase. Mexican concepts again led the segment with 2.8% growth, making it the segment leader for nine straight quarters. Domino's outperformed all other QSR concepts with YOY SSS growth of 6.3%. Sonic Drive-In performed well in Q3 2018 and led Sandwich concepts with a 2.6% increase in SSS; although, this growth follows eight consecutive quarters of SSS declines.

Fast Casual: The segment posted negative SSS growth for the eleventh consecutive quarter with a drop of 0.2%. This downward trend follows 26 quarters of SSS growth from Q3 2009 to Q4 2015. Zoe's Kitchen had a SSS decline of 7.6% YOY, representing the biggest drop in the segment. Noodles & Company continued to lead the segment with a 5.5% SSS increase in Q3 2018. Of the eight companies reporting, only three reported SSS growth YOY: Chipotle, El Pollo Loco and Noodles & Company.

Family Dining: Family dining turned positive in Q3 2018 with YOY growth of 0.5% following seven consecutive quarters of SSS declines. Luby's led the segment for the third straight quarter posting SSS growth of 3.9%. Of the six companies we track, Steak 'n Shake was the only negative concept with a SSS decrease of 6.9%. Chuck E. Cheese and IHOP continued their positive streaks with growth of 2.2% and 1.2%, respectively. Cracker Barrel and Denny's turned positive in Q3 2018 with growth of 1.4% and 1.0%, respectively.

Casual Dining: The casual dining segment extended its streak of positive quarterly results to four with SSS growth of 1.6% YOY. Of the 19 concepts we follow, 14 were positive for the quarter. Texas Roadhouse's 5.5% SSS growth marked its 35th consecutive positive quarter, while Applebee's delivered its strongest quarter in the past 10 years with growth of 7.7% YOY, which also marks four straight quarters of SSS growth of 2.0% or more for the brand. Kona Grill was the worst performing casual dining concept with a decline of 14.1%, its eighth consecutive decrease and second straight double digit decrease.

Fine Dining: Fine dining SSS turned positive in Q3 2018 with growth of 1.9%. Ruth Chris and Capital Grille posted solid SSS growth with increases of 3.9% and 3.7%, respectively. Del Frisco's Grille lagged the segment with a 0.4% decline, but this modest decrease was not enough to pull the segment into negative territory.

Contributing Editor Aaron Edwards is a Vice President at Trinity Capital.

Same-Store Sales Data

	FY 2015	FY 2016				FY 2017				FY 2018		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
QSR												
Chicken												
Bojangles	0.6%	2.0%	0.2%	0.8%	2.4%	(1.7%)	(1.4%)	(2.2%)	(3.1%)	(0.6%)	(0.2%)	0.4%
KFC	3.0%	1.0%	2.0%	6.0%	4.0%	2.0%	2.0%	1.0%	1.0%	0.0%	1.0%	1.0%
Pollo Tropical	0.4%	0.0%	(1.4%)	(1.0%)	(4.0%)	(6.7%)	(7.7%)	(10.9%)	(0.1%)	2.8%	3.4%	6.5%
Popeye's	2.0%	1.1%	0.0%	1.5%	3.0%	(0.4%)	(3.3%)	(2.6%)	(2.5%)	2.3%	1.8%	(0.2%)
Mean	**1.5%**	**1.0%**	**0.2%**	**1.8%**	**1.4%**	**(1.7%)**	**(2.6%)**	**(3.7%)**	**(1.2%)**	**1.1%**	**1.5%**	**1.9%**
Coffee/Snack												
Baskin Robbins	4.4%	5.0%	0.6%	(0.9%)	0.9%	(2.4%)	(0.9%)	0.4%	5.1%	(1.0%)	(4.0%)	1.8%
Dunkin Donuts	1.8%	2.0%	0.5%	2.0%	1.9%	0.0%	0.8%	0.6%	0.8%	(0.5%)	1.4%	1.3%
Starbucks	9.0%	7.0%	4.0%	4.0%	3.0%	3.0%	5.0%	2.0%	2.0%	2.0%	1.0%	4.0%
Tim Horton's	5.8%	5.8%	5.9%	4.5%	3.6%	(0.1%)	(0.8%)	0.3%	0.1%	0.1%	0.0%	0.6%
Mean	**5.3%**	**5.0%**	**2.8%**	**2.4%**	**2.4%**	**0.1%**	**1.0%**	**0.8%**	**2.0%**	**0.2%**	**(0.4%)**	**1.9%**
Mexican												
Del Taco	5.8%	3.2%	3.3%	6.7%	5.5%	4.2%	7.1%	4.1%	2.4%	3.7%	3.3%	1.4%
Taco Bell	4.0%	1.0%	(1.0%)	3.0%	3.0%	8.0%	4.0%	3.0%	2.0%	1.0%	1.9%	5.0%
Mean	**4.9%**	**2.1%**	**1.2%**	**4.9%**	**4.3%**	**6.1%**	**5.6%**	**3.6%**	**2.2%**	**2.4%**	**2.6%**	**2.8%**
Pizza												
Domino's	10.7%	6.4%	9.7%	13.0%	12.2%	10.2%	9.5%	8.4%	4.2%	8.3%	6.9%	6.3%
Papa John's	1.9%	0.1%	4.8%	5.5%	3.8%	2.0%	1.4%	1.0%	(3.9%)	(5.3%)	(6.1%)	(9.8%)
Papa Murphy's	(3.1%)	(3.0%)	(4.0%)	(5.8%)	(7.8%)	(5.0%)	(4.3%)	(4.1%)	(2.6%)	(3.9%)	(2.4%)	(2.1%)
Pizza Hut	2.0%	5.0%	1.0%	(2.0%)	(4.0%)	(7.0%)	(3.0%)	0.0%	2.0%	4.0%	0.0%	1.0%
Pizza Inn	(1.7%)	(2.2%)	0.3%	0.2%	(1.2%)	0.1%	(9.5%)	1.4%	2.7%	2.3%	2.5%	2.3%
Mean	**2.0%**	**1.3%**	**2.4%**	**2.2%**	**0.6%**	**0.1%**	**(1.2%)**	**1.3%**	**0.5%**	**1.1%**	**0.2%**	**(0.5%)**
Sandwich												
Burger King	2.8%	4.4%	(0.8%)	(0.5%)	1.8%	(2.2%)	3.0%	4.0%	5.1%	4.2%	1.8%	(0.7%)
Jack in the Box	1.4%	0.0%	1.1%	2.0%	3.1%	(0.8%)	(0.2%)	(1.0%)	(0.2%)	(0.1%)	0.5%	0.5%
McDonald's	5.7%	5.4%	1.8%	1.3%	(1.3%)	1.7%	3.9%	4.1%	4.5%	2.9%	2.6%	2.4%
Sonic Drive-In	5.3%	6.5%	2.0%	(2.0%)	(2.0%)	(7.4%)	(1.2%)	(3.3%)	(1.7%)	(2.9%)	(0.2%)	2.6%
Wendy's	4.8%	3.6%	0.4%	1.4%	0.8%	1.6%	3.2%	2.0%	1.3%	1.6%	1.9%	(0.2%)
Mean	**4.0%**	**4.0%**	**0.9%**	**0.4%**	**0.5%**	**(1.4%)**	**1.7%**	**1.2%**	**1.8%**	**1.1%**	**1.3%**	**0.9%**
Mean Total QSR	**3.3%**	**2.7%**	**1.5%**	**2.0%**	**1.4%**	**(0.0%)**	**0.4%**	**0.4%**	**1.0%**	**1.0%**	**0.9%**	**1.2%**
Fast Casual												
Chipotle	(14.6%)	(29.7%)	(23.6%)	(21.9%)	(4.8%)	17.8%	8.1%	1.0%	0.9%	2.2%	3.3%	4.4%
El Pollo Loco	1.8%	0.7%	2.4%	1.6%	(1.3%)	(0.3%)	2.9%	1.7%	1.4%	(1.1%)	(0.9%)	2.6%
Fuddrucker's	1.3%	0.0%	(1.0%)	(0.8%)	(1.6%)	(1.1%)	(0.9%)	(3.6%)	0.6%	0.6%	(5.8%)	(3.9%)
Noodles & Company	(1.1%)	(0.1%)	(1.0%)	(0.7%)	(1.3%)	(2.0%)	(3.4%)	(3.5%)	(0.9%)	(0.2%)	5.4%	5.5%
Pie Five	(1.6%)	(4.0%)	(12.0%)	(14.7%)	(17.4%)	(15.8%)	(16.2%)	(17.3%)	(13.7%)	(12.6%)	(6.4%)	(1.8%)
Potbelly	3.7%	3.7%	1.7%	0.6%	0.1%	(3.1%)	(4.9%)	(4.8%)	(2.4%)	(3.6%)	(0.2%)	(0.2%)
Shake Shack	11.0%	9.9%	4.5%	2.9%	1.6%	(2.5%)	(1.8%)	(1.6%)	0.8%	1.7%	1.1%	(0.7%)
Zoe's Kitchen	7.7%	8.1%	4.0%	2.4%	0.7%	(3.3%)	(3.8%)	(0.5%)	0.3%	(1.5%)	(2.5%)	(7.6%)
Mean	**1.0%**	**(1.4%)**	**(3.1%)**	**(3.8%)**	**(3.0%)**	**(1.3%)**	**(2.5%)**	**(3.6%)**	**(1.6%)**	**(1.8%)**	**(0.8%)**	**(0.2%)**

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

Same-Store Sales Data (Cont.)

	FY 2015	FY 2016				FY 2017				FY 2018		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Family Dining												
Chuck E Cheese	1.3%	6.0%	2.6%	3.7%	(1.6%)	(2.8%)	(3.8%)	(6.9%)	(6.0%)	(5.1%)	1.0%	2.2%
Cracker Barrel	0.6%	2.3%	3.2%	1.3%	0.6%	(0.4%)	(0.8%)	0.2%	1.1%	1.5%	(2.6%)	1.4%
Denny's	2.9%	2.5%	(0.5%)	1.0%	0.5%	(1.1%)	2.6%	0.6%	2.2%	1.5%	(0.7%)	1.0%
IHOP	1.4%	1.5%	0.2%	(0.1%)	(2.1%)	(1.7%)	(2.6%)	(3.2%)	(0.4%)	1.0%	0.7%	1.2%
Luby's	1.2%	3.1%	(0.2%)	0.0%	(2.2%)	(4.4%)	(2.5%)	(4.5%)	1.5%	1.5%	2.4%	3.9%
Steak n Shake	3.6%	1.8%	(0.7%)	0.2%	(0.4%)	(3.3%)	(3.1%)	(2.2%)	(1.8%)	(1.7%)	(3.4%)	(6.9%)
Mean	**1.8%**	**2.9%**	**0.8%**	**1.0%**	**(0.9%)**	**(2.3%)**	**(1.7%)**	**(2.7%)**	**(0.6%)**	**(0.2%)**	**(0.4%)**	**0.5%**
Casual Dining												
Applebee's	(2.5%)	(3.7%)	(4.2%)	(5.2%)	(7.2%)	(7.9%)	(6.2%)	(7.7%)	1.3%	3.3%	5.7%	7.7%
Bahama Breeze	2.4%	9.9%	4.7%	3.9%	2.6%	0.5%	1.4%	1.2%	2.5%	0.2%	0.6%	1.1%
BJ's Restaurants	0.7%	0.6%	(0.2%)	(3.4%)	(2.2%)	(1.3%)	(1.4%)	(1.7%)	1.6%	4.2%	5.6%	6.9%
Bonefish	(5.4%)	(2.7%)	0.9%	1.7%	(1.9%)	(0.8%)	(2.6%)	(4.3%)	0.6%	0.9%	1.5%	1.8%
Carrabba's Italian Grill	(4.0%)	(2.0%)	(4.8%)	(2.1%)	(2.3%)	(3.8%)	0.4%	(2.8%)	1.3%	0.9%	(0.6%)	(0.6%)
Cheesecake Factory	1.1%	1.7%	0.3%	1.7%	1.1%	0.3%	(0.5%)	(2.3%)	(0.9%)	2.1%	1.4%	1.5%
Chili's Grill & Bar	(2.1%)	(3.6%)	(1.8%)	(1.3%)	(3.2%)	(1.7%)	(1.7%)	(3.0%)	(1.6%)	(1.1%)	0.4%	1.9%
Chuy's	3.2%	3.2%	1.0%	0.3%	(1.1%)	(0.7%)	(1.0%)	(2.1%)	1.3%	(1.5%)	1.0%	0.5%
Dave & Buster's	6.0%	3.6%	1.0%	5.9%	3.2%	2.2%	1.1%	(1.3%)	(5.9%)	(4.9%)	(2.4%)	(1.3%)
Famous Dave's	(5.2%)	(6.1%)	(4.3%)	(3.8%)	(4.7%)	(4.8%)	(3.2%)	(1.5%)	1.8%	(0.9%)	(1.6%)	(1.4%)
Joe's Crab Shack	(2.9%)	(1.3%)	(6.8%)	(6.5%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Kona Grill	3.2%	3.6%	2.5%	0.7%	(4.1%)	(4.3%)	(5.3%)	(7.2%)	(6.5%)	(8.3%)	(12.1%)	(14.1%)
LongHorn Steakhouse	2.6%	5.2%	2.2%	0.6%	0.1%	0.2%	3.5%	2.6%	3.8%	2.0%	2.4%	3.1%
Maggiano's	(1.8%)	0.2%	(1.7%)	(0.6%)	(0.8%)	1.6%	0.5%	(2.6%)	1.8%	0.5%	0.3%	0.0%
Olive Garden	2.8%	4.9%	2.4%	2.0%	2.6%	1.4%	4.4%	1.9%	3.0%	2.2%	2.4%	5.3%
Outback	(2.2%)	(1.3%)	(2.5%)	(0.7%)	(4.8%)	1.4%	0.3%	0.6%	4.7%	4.3%	4.0%	4.6%
Red Robin	(1.6%)	(2.2%)	(3.2%)	(3.3%)	(4.4%)	(1.5%)	0.5%	(0.1%)	2.7%	(0.9%)	5.7%	(3.4%)
Taco Cabana	3.3%	1.7%	(3.8%)	(4.1%)	(3.5%)	(4.5%)	(4.7%)	(12.6%)	(7.4%)	0.9%	3.1%	12.2%
Texas Roadhouse	4.4%	4.3%	4.2%	3.4%	1.4%	3.2%	4.0%	4.5%	5.8%	4.9%	5.7%	5.5%
Mean	**0.1%**	**0.8%**	**(0.7%)**	**(0.6%)**	**(1.5%)**	**(1.1%)**	**(0.6%)**	**(2.0%)**	**0.5%**	**0.5%**	**1.2%**	**1.6%**
Fine Dining												
Fleming's	(0.3%)	1.3%	(0.8%)	(1.9%)	0.2%	(2.9%)	(1.3%)	(1.0%)	3.1%	2.9%	0.3%	0.5%
Ruth's Chris	3.2%	3.1%	1.5%	2.1%	0.0%	0.7%	2.9%	(1.6%)	1.5%	1.1%	1.3%	3.7%
Capital Grille	1.5%	5.3%	3.7%	(1.2%)	1.2%	0.9%	0.5%	2.0%	3.8%	2.8%	2.6%	3.9%
Del Frisco's Grille	(4.5%)	5.3%	(2.0%)	(1.4%)	2.7%	(0.9%)	(3.2%)	(5.4%)	0.9%	(1.4%)	0.7%	(0.4%)
Mean	**0.0%**	**3.8%**	**0.6%**	**-0.6%**	**1.0%**	**-0.6%**	**-0.3%**	**-1.5%**	**2.3%**	**1.4%**	**1.2%**	**1.9%**

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

Power-Sharing by Franchisors and Franchisees: What Works Best?

In an ideal franchised restaurant system, the franchisor is responsible for product, pricing and promotion, and the franchisee concentrates on four-wall execution of quality, service and cleanliness. Recent squabbles between franchisees and franchisors in the Jack-in-the-Box, McDonald's and Papa John's franchise systems have highlighted power-sharing issues ranging from remodeling initiatives to product and brand strategy and have, in the case of McDonald's, encouraged the formation of a franchise association.

An essential element of the power balance between franchisees and franchisors are franchise associations, which organize franchisees into a unified, constructive voice. Franchise associations can define key issues, create committees to develop expertise around those disciplines and constructively provide valuable customer and market feedback to the franchisor. One of the most important things for franchisor executives to keep in mind is that frequent discussions with franchisees are critical in establishing the reciprocal relationship necessary to grow and compete successfully. Leading brands realize this important partnership can establish the foundation for successfully working together and co-investing in solutions to differentiate the brand from its competition. This requires periodic dialogue, candid disclosure and comprehensive analysis. Effective communication is critical to success and must be accompanied by a balance of power, not franchisor hegemony. Strong franchisors recognize the importance of a strong franchise association. David Novak, former Chairman of YUM! Brands, once told franchisees at a FRANMAC (Taco Bell's franchise association) conference, "you make us a better brand."

Unfortunately, there are forces that work against dialogue, disclosure and comprehensive analysis. When a brand is on a strong upswing, the franchisor can tend to be imperious, often without realizing it. On the other hand, brands that have lost their way are sometimes so browbeaten by franchisees that they seemingly will never regain their composure. This breakdown often leads to intransigence and competing agendas instead of ideas on how to beat the competition.

Publicly traded franchisors are typically concerned with shareholder sentiment and top-line growth at the restaurants, while franchisees place greater focus on bottom-line sustainability or expansion. There is not necessarily a conflict of interest but a delicate balance between the cash flow of the brand (franchisor) and its franchisees. If a concept's franchisees have average system-wide cash flow of 10% and royalties of 5%, then the effective split of cash flow is two-thirds to the franchisee and one-third to the franchisor. The calculation becomes more complicated when you look at capital structures, debt service, remodeling costs and development. If a franchisee is feverishly investing in remodeling, then the franchisor benefits substantially from the franchisee's investments (assuming there is a meaningful sales bump from remodeling) without directly bearing the costs of construction. While the franchisee will likely see improved cash flow from top-line growth, it may be negated by payments on debt incurred to complete the project, changing the equation. It is important that there is an acknowledgement of the relationship between royalties and free cash flow.

To analyze the equitability of the relationship, franchisees may examine and question the ways in which the franchisor is using its cash flow and debt proceeds. If a meaningful quotient of that money is used to strengthen the brand through technology enhancement, promotion, product research and the like, then franchisees can take comfort in the notion that reinvestment is occurring on both sides of the aisle. On the other hand, if the franchisor's uses of debt proceeds are heavily skewed toward share repurchases and dividends while brand performance is suffering, it may indicate the balance of power is not working well.

An additional area where a strong franchisor-franchisee relationship plays a role is product and promotional strategy. If the franchisor acts unilaterally when determining promotional offerings – examples of which include mandating franchisees to offer unsustainable value items that cannibalize sales from high-margin products – it may lose the trust of its franchisees and exacerbate any existing relationship woes. When the franchisor and franchisee work together and communicate effectively, the brand can launch new promotions like Applebee's Dollarita, which turned out to be an incredibly successful traffic driver and helped reinvigorate the brand, benefiting both the franchisor and franchisees.

Without an open line of communication between the franchisor and franchisees, franchisees neglecting remodeling or development can lead brand management to conclude that their growth is stifled by franchisee reluctance to reinvest. Conversely, franchisees can suffer or be impaired by unreasonably priced remodel obligations and poorly constructed technology and promotional programs that

require significant capital, but do not produce meaningful results.

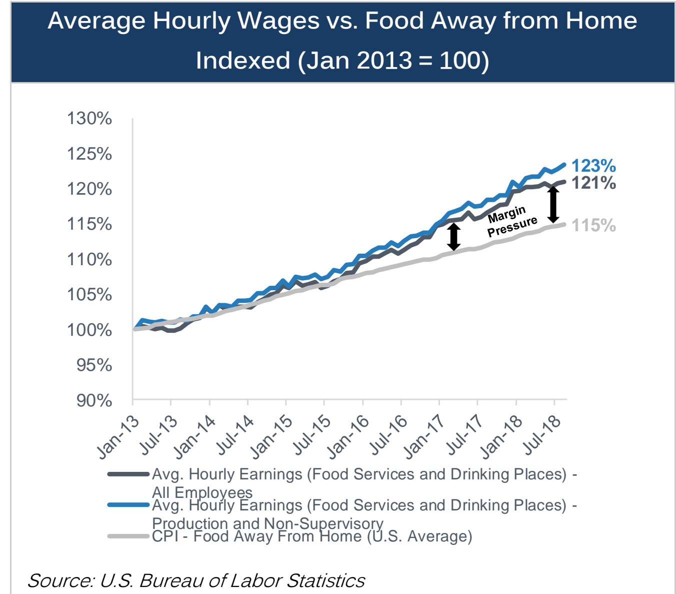
Successful brands maintain constructive and synergistic relationships between franchisee and franchisor. If one side is not listening, this can lead to a degradation in morale on both sides and ultimately in brand performance. Unresolved disputes compound and lead to occurrences (like legal battles) that are meaningfully destructive to both parties; it is always best to have a full-disclosure, comprehensive discussion about a difficult matter before it breeds animus. A healthy franchisor-franchisee relationship does not mean there will not be disagreements, but that there is mutual respect and a forum for airing grievances and solving legitimate challenges or misperceptions. Effective franchise associations are the surest way to keep open, periodic and constructive dialogue.

Contributing Editor Kevin Burke is a Managing Director at Trinity Capital.

The Challenges of Labor Pressures for Restaurant Operators

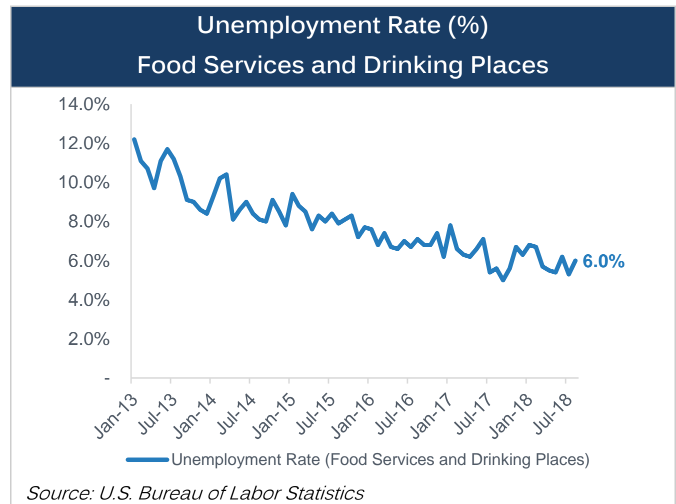
While there are many critical factors restaurant operators face when seeking to optimize their efficiencies and maximize profitability, labor is near the top of that list. Representing approximately a quarter to one-third overall operating costs, these costs can dramatically set apart the top operators from the mid and lower tier operators. Best in class operators are able to effectively maintain controls over employee scheduling, shift management, limiting overtime pay and employee turnover.

That being said, even best-in-class operators may face significant headwinds as it relates to overall wage increase pressures. In today's current environment, average hourly wages continue to be pushed higher by increased competition within the labor market and arbitrary government mandates (in some cases up to $15.00 per hour). As shown in the chart above right, wage increases have outweighed the overall inflation for Food Away from Home, a proxy for restaurant operator price increases. This wage versus price increase gap has continued to widen since late 2015.



Source: U.S. Bureau of Labor Statistics

One of the main driving factors aside from government mandated minimum wage increases is the highly competitive labor environment. The unemployment rate has been trending down since the recession and has been hovering at or below 6.0% for the recent months which may be driven by substantial new store growth absorbing unemployed workers. While the low unemployment may be considered an indicator of a relatively strong economy, this can pose potential issues to restaurant operators, particularly those who may experience high employee turnover. The high competition for labor not only drives up market wages as operators are fighting to win over talent in their labor pools, but also increases the lead time needed for hiring.



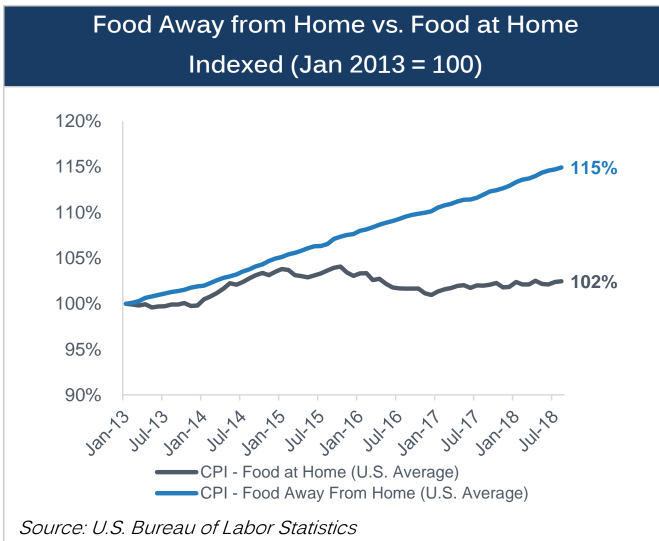
Source: U.S. Bureau of Labor Statistics

A restaurant operator's employees are critical to the success of their businesses and the margin pressure being from higher wages may simply be the new paradigm. Operators will have

to look at other payroll characteristics to reduce or maintain overall expenses. Successful operators will be able to optimize their labor costs through scheduling efficiencies (i.e. reducing redundancies through shift staffing management) and minimizing on-boarding and training costs achieved by low turnover rates.

If we're truly in a new paradigm of higher wages and payroll expenses, operators may look to pass along a portion of these costs through menu price increases. This could pose challenges of acceptance by the overall consumer who may choose to take their business elsewhere and therefore reducing overall sales volume. Another potential threat to raising prices further is that the consumer's alternative to spending money at a restaurant is purchasing food for consumption at home. Prices for food purchased at grocery stores and other wholesale retailers have seen a significant divergence from food consumption at restaurants and while we may not have seen a dramatic shift in consumer behaviors a hiccup in the economy could quickly shift consumers with lower disposable income away from higher priced menu items.

Food Away from Home vs. Food at Home Indexed (Jan 2013 = 100)



Source: U.S. Bureau of Labor Statistics

The majority of restaurant operators are experiencing the same labor cost pressures on their overall profitability margins, just to different degrees of impact based on geography and demographics. It remains unclear how high wages will ultimately go and how long we will remain in a tight labor market, but payroll costs are certainly are on the rise and it will be important for operators to proactively manage their payroll expenses to sustain profitability.

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The Perfect Employee

Note: This article was originally published in Trinity Capital's Q2 2015 Restaurant Industry Commentary.

I was talking to a restaurant executive recently and he told me that he had found the perfect employee. He said the employee was never late, never complained, was never sick, never took vacation, never asked for a raise, never fought with other employees, was never guilty of food safety violations, had perfect order accuracy and even refused benefits. I asked him who was this employee and he replied, "his name is *Kiosk*".

Automated kiosks are not a new concept to the restaurant industry. I remember seeing them in a McDonald's in Budapest in 1995. The kiosk had a crude video screen that would query what you wanted to order and then you would pay for the items with a credit card or you could even feed paper currency into the machine. Today, technology has improved by leaps and bounds and the human interface available in industry-leading kiosk manufacturers is amazing and makes these devices very profitable. Companies such as Nextep Systems and SeePoint have developed outstanding point-of-sale kiosks that provide customer interaction, ordering and payment functions for restaurants. There are number of factors driving this development and chief among them is monumental increases in wages caused by minimum-wage legislation in many jurisdictions around the country.

Communities such as New York, Los Angeles and Seattle, Berkeley and many others across the nation have adopted wage legislation that significantly increases the present and future minimum-wage requirements for establishments with requisite numbers of employees and sales. Some industry and press pundits have mistakenly surfaced the notion that 50% and 100% increases in crew level wages can be passed onto the consumer. This could not be farther from the truth. Five of the top 10 QSR chains right now are engaged in studying their value menu and making changes to bundling offerings that will bring check averages down. This is in response to a tepid economy both globally and at home. The notion that significant increases in minimum wage will somehow generate more traffic in local area QSR establishments as a meaningful offset to higher labor costs is a fallacy. QSR traffic is heavily correlated with price, offering, location, advertising, promotion and motor fuel prices, but not prevailing local minimum wages.

One of the unintended consequences of advancing minimum wages is that the whole cost structure of the restaurant must

undergo a significant shift to accommodate sizeable increases in crew wages. Consider that when prevailing minimum wage is $7.50 and the local jurisdiction enacts legislation which increases it by two dollars a year for four consecutive years, there are many other costs associated with this legislation in addition to direct crew labor. Social Security, workers compensation, unemployment insurance and payroll taxes dramatically increase when double-digit minimum-wage percentage increases become effective. In addition, shift leaders, night and assistant managers and restaurant general managers all require significant wage increases to maintain parity with the prevailing minimum wage paid to crews. Without offsetting price increases, this kind of wage inflation can quickly erode a restaurants ability to produce consistent positive cash flow. QSR executives will be almost unanimous in seconding the notion that dramatic minimum-wage increases in the 50% to 100% range are not anywhere near fully recoverable through menu price increases. Consequently, significant losses can occur very quickly in QSR establishment that are unable to pass on dramatic wage, payroll and associated cost increases.

The nation's restaurant industry has long been a fertile training ground for training and experience which provides employees with the opportunity to advance in the industry. Restaurants provide more jobs than any other industry (except government) and the job market is very efficient because entry-level wages are typically not a burden for entrepreneurs. Most minimum-wage employees are students and Millennials who do not plan on staying at the job very long (the average QSR crew-level length of employment is approximately 90 days) and are by no means head of household or looking for a "living wage". The Department of Labor conducted a study and found that minimum-wage employees earned $1.40 per hour more by remaining in employment for one year. Good employers tend to pay a little more than minimum wage, but more importantly, they rapidly promote individuals that exhibit the character, drive and job skills requisite for moving into a role of increasing responsibility.

I was recently interviewed by a national publication at the university where I teach. They asked me what I would do about a 35-year-old head of household with two children and a wife to support working in the QSR industry at $7.50 an hour. Without hesitating I replied that in the 17 years since graduating high school (assuming this individual is not a convicted felon) this employee apparently failed to generate any more job skills that a 16-year-old high school student would have in his or her first job. This is failure to accumulate appreciable skills in the marketplace. Legislating to reward market place ineptitude will breed more of the same. Generally, what you subsidize you get more of, and what you penalize you get less of. Expensive traffic tickets really discourage speeding.

Most of the large restaurant chains around the country are thoroughly investigating ways in which kiosks can provide value in their restaurants through cost reduction, upselling, speed of service, order accuracy, convenience and location. It seems that the intensity of this technological shift has been exacerbated by the continuous drumbeat of minimum-wage legislation sweeping through the nations large cities. State and local governments must carefully consider what they will achieve by pushing this agenda. I firmly believe that the full costs of glacial minimum-wage increases are not well understood by the marketplace or politicians that have surfaced these bills. In the medium and long run businesses move rapidly to environments that produce greater profits. Everybody remembers what happened to the industries targeted by organized labor in the 1960s and 1970s… their business went to Japan. That would include manufacturers of cameras, stereo systems, consumer electronics, radios, televisions, tool and die parts and steel.

Kiosks provide tremendous benefits in addition to a static hourly cost which are highly attractive for retail establishments struggling to deal with wages which have recently become a higher percentage of revenues than they have been historically. We believe that the modest incursions of kiosks into the QSR industry thus far will change dramatically in the years to come as the cost and benefits of these devices becomes starkly more profitable than hourly wage employees. Unfortunately, there is a human cost here which thus far seems to have eluded the discussions.

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