Restaurant Industry Commentary & Same-Store Sales Data

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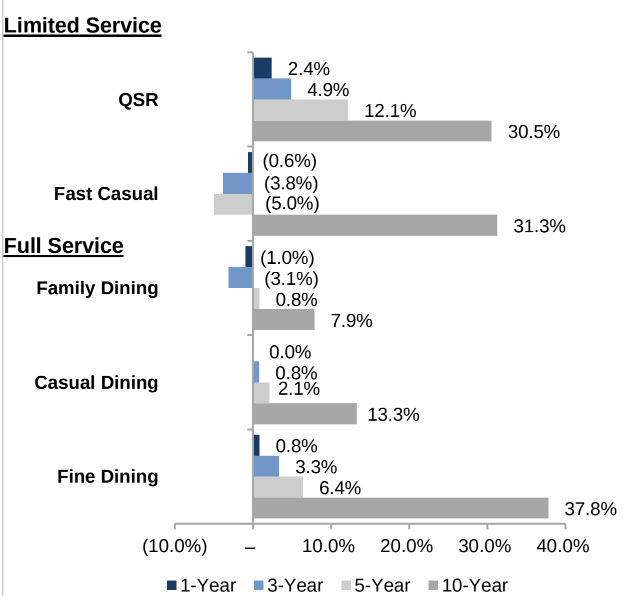
Same-Store Sales Discussion

Restaurant industry same-store sales ("SSS") increased for the eighth straight quarter in Q3 2019 following six consecutive quarters of SSS declines. Of the 50 companies reporting SSS results this quarter, 33, or 66.0%, generated SSS growth. It is worth noting that five years ago, we tracked 74 restaurant concepts and that today, only 50 report SSS as a result of many, mostly struggling, concepts being taken private.

As shown in the figure below, long-term performance, measured over 3-, 5- and 10-year periods, has been most consistent in QSR. Fine dining outperformed all other segments over the past 10 years (+37.8%); however, the segment was hit hardest by the Great Recession, so the starting point was also the lowest. QSR led the industry with 2.4% growth in Q3 2019, extending its positive streak to eight quarters.

Cumulative Q3 2019 SSS by Segment



Source: Company filings; Technomic, Inc.

QSR: The QSR segment extended its streak of positive year-over-year ("YOY") SSS growth to 10 quarters with a 2.4% increase. Sandwich concepts led the segment for the first time in nearly four years with 4.3% growth, bolstered by strong performances from Burger King (+5.0%) and McDonald's (+4.8%). Chicken concepts repeated their positive result in Q3 with a 1.8% increase, driven by Popeye's (+10.2%) and the popularity of its chicken sandwich, partially offset by KFC (-1.0%) and Pollo Tropical (-3.8%). Domino's (+2.4%) delivered another strong quarter in Q3; however, this represents a sixth consecutive quarter of slowed growth. The Mexican (+2.5%) and coffee/snack (+2.4%) segments also posted modest growth led by Taco Bell (+4.0%) and Starbucks (+6.0%), respectively.

Fast Casual: Results for fast casual concepts were mixed in Q3, with strong performance for Chipotle (+11.0%), Shake Shack (+2.0%) and Noodles & Company (+2.1%), and losses for Pie Five (-12.2%) and Potbelly (-3.0%). On average, sales were slightly negative (-0.6%) for the segment.

Family Dining: Family dining again saw a slight YOY decrease (-1.0%) with strong results for Cracker Barrel (+3.8%) offset by another weak quarter for Steak n Shake (-6.5%), which turned in the worst results in the segment for the sixth consecutive quarter and extended its losing streak to 12 quarters.

Casual Dining: The casual dining segment was flat for the quarter. This marks its eighth consecutive quarter without a decrease in comp sales. Texas Roadhouse (+4.4%) led the segment with its 39th consecutive positive quarter. Other strong performers included Chuy's (+2.6%) and Chili's (+2.3%), both of which turned in positive results for the sixth consecutive quarter. Red Robin (+1.6%) recorded its first positive performance in seven quarters. Taco Cabana (-4.8%) and Bahama Breeze (-4.2%) lagged the segment.

Fine Dining: Every fine dining concept that reported SSS in Q3 served up positive results, as the segment continued to perform well with a 0.8% average SSS increase. Capital Grille (+1.9%) led the pack, with Fleming's (+0.4%) and Ruth's Chris (+0.6%) posting more modest increases. Additionally, fine dining steak chains continued to be outperformed by casual steak chains in Q3 2019.

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

Same-Store Sales Data

	FY 2016	FY 2017				FY 2018				FY 2019		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
QSR												
Chicken												
KFC	4.0%	2.0%	2.0%	1.0%	1.0%	0.0%	1.0%	1.0%	1.0%	2.0%	2.0%	(1.0%)
Pollo Tropical	(4.0%)	(6.7%)	(7.7%)	(10.9%)	(0.1%)	2.8%	3.4%	6.5%	(1.9%)	(2.6%)	(1.3%)	(3.8%)
Popeye's	3.0%	(0.4%)	(3.3%)	(2.6%)	(2.5%)	2.3%	1.8%	(0.2%)	(0.1%)	0.4%	2.9%	10.2%
Mean	**1.0%**	**(1.7%)**	**(3.0%)**	**(4.2%)**	**(0.5%)**	**1.7%**	**2.1%**	**2.4%**	**(0.3%)**	**(0.1%)**	**1.2%**	**1.8%**
Coffee/Snack												
Baskin Robbins	0.9%	(2.4%)	(0.9%)	0.4%	5.1%	(1.0%)	(4.0%)	1.8%	(3.7%)	(2.8%)	(1.4%)	3.6%
Dunkin Donuts	1.9%	0.0%	0.8%	0.6%	0.8%	(0.5%)	1.4%	1.3%	0.0%	2.4%	1.7%	1.5%
Starbucks	3.0%	3.0%	5.0%	2.0%	2.0%	2.0%	1.0%	4.0%	4.0%	4.0%	7.0%	6.0%
Tim Horton's	3.6%	(0.1%)	(0.8%)	0.3%	0.1%	0.1%	0.0%	0.6%	1.9%	(0.6%)	0.5%	(1.4%)
Mean	**2.4%**	**0.1%**	**1.0%**	**0.8%**	**2.0%**	**0.2%**	**(0.4%)**	**1.9%**	**0.6%**	**0.8%**	**2.0%**	**2.4%**
Mexican												
Del Taco	5.5%	4.2%	7.1%	4.1%	2.4%	3.7%	3.3%	1.4%	1.9%	(0.1%)	2.2%	1.0%
Taco Bell	3.0%	8.0%	4.0%	3.0%	2.0%	1.0%	1.9%	5.0%	6.0%	4.0%	7.0%	4.0%
Mean	**4.3%**	**6.1%**	**5.6%**	**3.6%**	**2.2%**	**2.4%**	**2.6%**	**2.8%**	**2.8%**	**2.0%**	**3.7%**	**2.5%**
Pizza												
Domino's	12.2%	10.2%	9.5%	8.4%	4.2%	8.3%	6.9%	6.3%	5.6%	3.9%	3.0%	2.4%
Papa John's	3.8%	2.0%	1.4%	1.0%	(3.9%)	(5.3%)	(6.1%)	(9.8%)	(8.1%)	(6.9%)	(5.7%)	1.0%
Pizza Hut	(4.0%)	(7.0%)	(3.0%)	0.0%	2.0%	4.0%	0.0%	1.0%	1.0%	0.0%	2.0%	(3.0%)
Pizza Inn	(1.2%)	0.1%	(9.5%)	1.4%	2.7%	2.3%	2.5%	2.3%	2.7%	3.3%	0.0%	3.1%
Mean	**2.7%**	**1.3%**	**(0.4%)**	**2.7%**	**1.3%**	**2.3%**	**0.8%**	**(0.1%)**	**0.3%**	**0.1%**	**(0.2%)**	**0.9%**
Sandwich												
Burger King	1.8%	(2.2%)	3.0%	4.0%	5.1%	4.2%	1.8%	(0.7%)	0.8%	0.4%	0.5%	5.0%
Jack in the Box	3.1%	(0.8%)	(0.2%)	(1.0%)	(0.2%)	(0.1%)	0.5%	0.5%	(0.1%)	0.2%	2.7%	3.0%
McDonald's	(1.3%)	1.7%	3.9%	4.1%	4.5%	2.9%	2.6%	2.4%	2.3%	4.5%	5.7%	4.8%
Wendy's	0.8%	1.6%	3.2%	2.0%	1.3%	1.6%	1.9%	(0.2%)	0.2%	1.3%	1.4%	4.4%
Mean	**1.1%**	**0.1%**	**2.5%**	**2.3%**	**2.7%**	**2.2%**	**1.7%**	**0.5%**	**0.8%**	**1.6%**	**2.6%**	**4.3%**
Mean Total QSR	**2.1%**	**0.8%**	**0.9%**	**1.0%**	**1.6%**	**1.7%**	**1.2%**	**1.4%**	**0.8%**	**0.8%**	**1.8%**	**2.4%**
Fast Casual												
Chipotle	(4.8%)	17.8%	8.1%	1.0%	0.9%	2.2%	3.3%	4.4%	6.1%	9.9%	10.0%	11.0%
El Pollo Loco	(1.3%)	(0.3%)	2.9%	1.7%	1.4%	(1.1%)	(0.9%)	2.6%	4.4%	2.4%	0.7%	1.1%
Fuddrucker's	(1.6%)	(1.1%)	(0.9%)	(3.6%)	0.6%	0.6%	(5.8%)	(3.9%)	(11.2%)	(5.3%)	(6.1%)	(5.5%)
Noodles & Company	(1.3%)	(2.0%)	(3.4%)	(3.5%)	(0.9%)	(0.2%)	5.4%	5.5%	4.0%	3.0%	4.6%	2.1%
Pie Five	(17.4%)	(15.8%)	(16.2%)	(17.3%)	(13.7%)	(12.6%)	(6.4%)	(1.8%)	(3.6%)	(4.4%)	0.0%	(12.2%)
Potbelly	0.1%	(3.1%)	(4.9%)	(4.8%)	(2.4%)	(3.6%)	(0.2%)	(0.2%)	(1.7%)	(4.7%)	(4.0%)	(3.0%)
Shake Shack	1.6%	(2.5%)	(1.8%)	(1.6%)	0.8%	1.7%	1.1%	(0.7%)	2.3%	3.6%	3.6%	2.0%
Mean	**(3.5%)**	**(1.0%)**	**(2.3%)**	**(4.0%)**	**(1.9%)**	**(1.9%)**	**(0.5%)**	**0.8%**	**0.0%**	**0.6%**	**1.3%**	**(0.6%)**

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

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Same-Store Sales Data (Cont.)

	FY 2016	FY 2017				FY 2018				FY 2019		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Family Dining												
Chuck E Cheese	(1.6%)	(2.8%)	(3.8%)	(6.9%)	(6.0%)	(5.1%)	1.0%	2.2%	3.3%	7.7%	0.5%	(0.9%)
Cracker Barrel	0.6%	(0.4%)	(0.8%)	0.2%	1.1%	1.5%	(2.6%)	1.4%	3.8%	1.3%	1.3%	3.8%
Denny's	0.5%	(1.1%)	2.6%	0.6%	2.2%	1.5%	(0.7%)	1.0%	1.4%	1.3%	3.8%	1.1%
IHOP	(2.1%)	(1.7%)	(2.6%)	(3.2%)	(0.4%)	1.0%	0.7%	1.2%	3.0%	1.2%	2.0%	0.0%
Luby's	(2.2%)	(4.4%)	(2.5%)	(4.5%)	1.5%	1.5%	2.4%	3.9%	(3.0%)	(2.2%)	(3.1%)	(3.2%)
Steak n Shake	(0.4%)	(3.3%)	(3.1%)	(2.2%)	(1.8%)	(1.7%)	(3.4%)	(6.9%)	(5.1%)	(7.9%)	(5.9%)	(6.5%)
Mean	**(0.9%)**	**(2.3%)**	**(1.7%)**	**(2.7%)**	**(0.6%)**	**(0.2%)**	**(0.4%)**	**0.5%**	**0.6%**	**0.2%**	**(0.2%)**	**(1.0%)**
Casual Dining												
Applebee's	(7.2%)	(7.9%)	(6.2%)	(7.7%)	1.3%	3.3%	5.7%	7.7%	3.5%	1.8%	(0.5%)	(1.6%)
Bahama Breeze	2.6%	0.5%	1.4%	1.2%	2.5%	0.2%	0.6%	1.1%	(1.1%)	(3.7%)	1.9%	(4.2%)
BJ's Restaurants	(2.2%)	(1.3%)	(1.4%)	(1.7%)	1.6%	4.2%	5.6%	6.9%	4.5%	2.0%	2.0%	(0.3%)
Bonefish	(1.9%)	(0.8%)	(2.6%)	(4.3%)	0.6%	0.9%	1.5%	1.8%	(1.1%)	1.9%	0.1%	(2.2%)
Carrabba's Italian Grill	(2.3%)	(3.8%)	0.4%	(2.8%)	1.3%	0.9%	(0.6%)	(0.6%)	0.8%	0.3%	(1.6%)	0.1%
Cheesecake Factory	1.1%	0.3%	(0.5%)	(2.3%)	(0.9%)	2.1%	1.4%	1.5%	1.9%	1.3%	1.0%	0.4%
Chili's Grill & Bar	(3.2%)	(1.7%)	(1.7%)	(3.0%)	(1.6%)	(1.1%)	0.4%	1.9%	3.0%	2.7%	1.3%	2.3%
Chuy's	(1.1%)	(0.7%)	(1.0%)	(2.1%)	1.3%	(1.5%)	1.0%	0.5%	0.9%	3.2%	1.9%	2.6%
Dave & Buster's	3.2%	2.2%	1.1%	(1.3%)	(5.9%)	(4.9%)	(2.4%)	(1.3%)	2.9%	(0.3%)	(3.3%)	(3.2%)
Famous Dave's	(4.7%)	(4.8%)	(3.2%)	(1.5%)	1.8%	(0.9%)	(1.6%)	(1.4%)	(1.5%)	(0.7%)	0.4%	1.9%
LongHorn Steakhouse	0.1%	0.2%	3.5%	2.6%	3.8%	2.0%	2.4%	3.1%	2.9%	3.8%	3.3%	2.6%
Maggiano's	(0.8%)	1.6%	0.5%	(2.6%)	1.8%	0.5%	0.3%	0.0%	1.8%	0.4%	(0.2%)	(1.8%)
Olive Garden	2.6%	1.4%	4.4%	1.9%	3.0%	2.2%	2.4%	5.3%	3.5%	4.3%	2.4%	2.2%
Outback	(4.8%)	1.4%	0.3%	0.6%	4.7%	4.3%	4.0%	4.6%	2.9%	3.5%	1.3%	0.2%
Red Robin	(4.4%)	(1.5%)	0.5%	(0.1%)	2.7%	(0.9%)	(2.6%)	(3.4%)	(4.5%)	(3.3%)	(1.5%)	1.6%
Taco Cabana	(3.5%)	(4.5%)	(4.7%)	(12.6%)	(7.4%)	0.9%	3.1%	12.2%	5.1%	(0.5%)	(3.0%)	(4.8%)
Texas Roadhouse	1.4%	3.2%	4.0%	4.5%	5.8%	4.9%	5.7%	5.5%	5.6%	5.2%	4.7%	4.4%
Mean	**(1.5%)**	**(1.0%)**	**(0.3%)**	**(1.8%)**	**1.0%**	**1.0%**	**1.6%**	**2.7%**	**1.8%**	**1.3%**	**0.6%**	**0.0%**
Fine Dining												
Fleming's	0.2%	(2.9%)	(1.3%)	(1.0%)	3.1%	2.9%	0.3%	0.5%	(0.4%)	0.6%	1.6%	0.4%
Ruth's Chris	0.0%	0.7%	2.9%	(1.6%)	1.5%	1.1%	1.3%	3.7%	(0.1%)	1.8%	(0.5%)	0.6%
Capital Grille	1.2%	0.9%	0.5%	2.0%	3.8%	2.8%	2.6%	3.9%	3.7%	4.3%	2.9%	1.5%
Mean	**0.5%**	**(0.4%)**	**0.7%**	**(0.2%)**	**2.8%**	**2.3%**	**1.4%**	**2.7%**	**1.1%**	**2.2%**	**1.3%**	**0.8%**

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

Importance of Embracing Restaurant Technologies

Whether franchisors and franchisees like it or not, technology and automation has taken the restaurant industry by storm. The competitive pressures are mounting as brands fight for their share of the consumer wallet all while continuing to mitigate cost pressures from wage and commodity increases. How will brands and franchisees fight to thrive and/or survive?

The answer to that question is not a simple formula and requires cooperation and investment from both franchisors and franchisees. In order to lift franchisees with low margins, franchisors are investing in their technology to drive sales and create operational efficiencies.

Taco Bell, as an example, has been a technological leader by investing its overall infrastructure to address the mobile ordering, kiosk and delivery demands from its millennial customer base.

McDonalds, on the other hand, has been actively acquiring technology companies and integrating them into their infrastructure. In the past year, the company acquired two Artificial Intelligence (AI) companies, Dynamic Yield and Apprente, and acquired a 10% stake in Plexure Group, a mobile engagement software company. Dynamic Yield is changing the way brands are utilizing data to optimize sales and improve the customer experience. The new AI technology, currently implemented at over 1,000 drive-thru windows, takes a multi-factor approach by analyzing weather, traffic patterns and historical sales to personalize the drive-thru experience.

McDonald's Drive-Thru Technology

Source: McDonald's corporate website

While not every brand is at the forefront of technology, it is becoming increasingly important for franchisees to evaluate its IT infrastructure alongside its remodel image requirements.

According to National Restaurant's Association's 2019 State of the Restaurant Industry Report, 80% of respondents stated that they planned to make technology investments this year.

Franchisees generally agree that there are significant competitive advantages to technological innovation. Now where should they begin? There are numerous aspects within their organizations that can be augmented through systems and hardware. Investments can be made in both front-of-house technologies (i.e., mobile ordering and payment interfaces) and back-of-house technologies (i.e., point-of-sale systems and inventory management software.) Many of these investments are sought to address the rapidly changing consumer demands for mobile options and delivery. There are no shortages of potential technology investments as shown below.

2019 Restaurant Tech Ecosystem

Source: Techtable and Better Food Ventures

As 2020 unfolds, QSR Magazine unveiled technology predictions from a group of restaurant experts which we will pay close attention to. These predictions include the following:

- Technology aimed at enhancing the delivery experience through streamlined logistics, restaurant configurations and consumer-facing applications
- Software to more effectively manage food waste and overall sustainability
- Management software and systems to retain talented managers through enhancing the work environment
- Back-of-house automation to ease employee tasks and shift focus onto its guests/customers

– Further plant-based product offerings through research and development investments

No matter if your brand is an innovator, market leader or a mass adopter, technology and automation is changing the way restaurants are being operated. It will critical to allocate capital towards these investments to maintain profit margins, to keep pace with competitors and to potentially gain market share.

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LIBOR is Ending: What this Means for You as a Borrower

In Summer 2017, the United Kingdom Financial Conduct Authority (FCA) announced that it would no longer compel member banks to provide London Inter-bank Offered Rate (LIBOR) information by the end of 2021, after which point in time there will be no LIBOR index. This is precipitated in part by the mass exodus of banks from London to Paris and Brussels as a result of the United Kingdom's departure from the European Union ("BREXIT"). This development will effectively terminate LIBOR as an index for pricing loans likely well before the deadline, and we expect a gradual abandonment of the use of the LIBOR indices as we approach the December 2021 "sunset" of LIBOR.

Prior to the enactment of LIBOR, the only indices that had global appeal were United States Treasury securities, particularly the 10-year treasury ("UST"); however, that was problematic for the global markets because currencies were much more volatile than they are today, and there could be disruptions based on trade, interest rates and other factors unrelated to the pricing of loans. The establishment of LIBOR in the early 1980s by the British Bankers Association provided an alternative to United States Treasury indices and, in turn, stabilized both indices. LIBOR has become the dominant index for variable-rate borrowing and has been the standard quote in the securitization and mortgage market for variable-rate mortgages.

Prior to BREXIT becoming an issue, the Federal Reserve Board convened a committee called the Alternative Reference Rates Committee in order to study US dollar loan reference indices in response to some of the irregularities by LIBOR reporting institutions (such as the rate rigging scandal), as well as regulatory concerns. The committee selected what they are calling the Secured Overnight Financing Rate ("SOFR") as a preferred reference rate for the replacement of LIBOR. Restaurant loan borrowers will soon be using the SOFR index instead of LIBOR.

While LIBOR data is self-reported, SOFR data is based on United States Treasury securities trades and therefore is entirely transparent and empirical. SOFR is an overnight United States Treasury repo quote and does not yet provide a solution for pricing long-term loans on the yield curve. One way in which SOFR differs materially from LIBOR is that there is no credit implication for the reporting institution as all the data points are from US Treasury securities, not reporting banks. Ostensibly, that will make SOFR a better index and immune from "bid-rigging" which happened with LIBOR in 2014. The SOFR made its initial debut in the futures and uncleared swaps market in the fourth quarter of 2018, and it was used for cleared swaps shortly thereafter.

Ever since the advent of restaurant loan securitization in the mid-1990s, most restaurant loans have been quoted as a spread to LIBOR, with the most popular indices being either 30 or 60 days, and restaurant lenders have almost completely abandoned quoting loans off the 10-year treasury or prime rate. Restaurant borrowers won't really notice much change other than the index being called by a different name (SOFR) and the interest rate spread will have to compensate for the small difference, if any, in overnight rates. This will not, however, affect absolute interest rates.

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