TRINITY CAPITAL
INVESTMENT BANKING

Restaurant Industry Commentary & Same-Store Sales Data

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Inside This Issue

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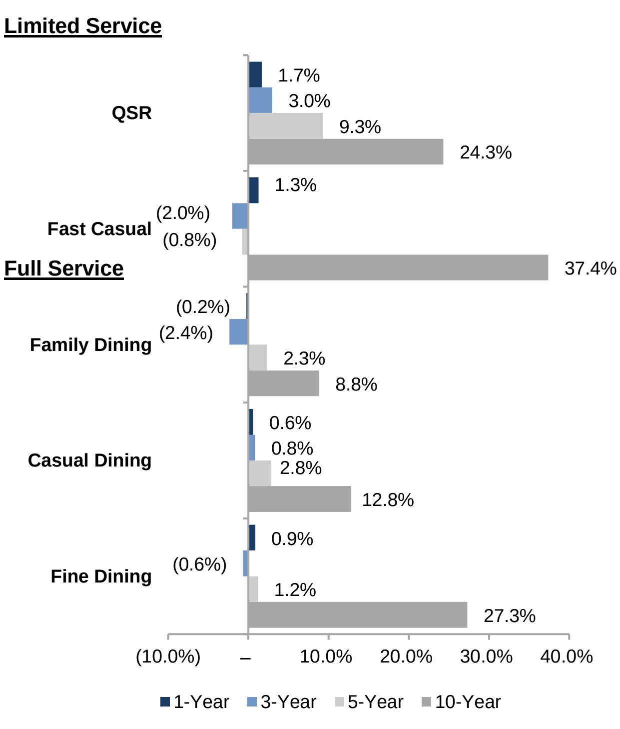
Same-Store Sales Discussion

Restaurant industry same-store sales ("SSS") increased for the seventh straight quarter in Q2 2019 following six consecutive quarters of SSS declines. Of the 52 companies reporting SSS results this quarter, 38, or 73.1%, generated SSS growth.

As shown in the figure below, long-term performance, measured over 3-, 5- and 10-year periods, has been most consistent in QSR. Fast casual provided the most growth over the past 10 years; however, the segment was *negative* over the past three years, as was the family dining segment. QSR led the industry with 1.7% growth in Q2 2019, extending its positive streak to nine consecutive quarters.

Cumulative Q2 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 nine consecutive quarters with a 1.7% increase. Mexican concepts led the segment for the 13th straight quarter with 3.7% growth, largely due to another strong quarter from Taco Bell (+7.0%). Chicken concepts rebounded from a disappointing Q1 with a 1.2% increase, driven by a 2.6% increase for Popeye's, partially offset by 2.6% decrease for Pollo Tropical, its third consecutive negative quarter. Domino's (+3.0%) delivered another strong quarter in Q2, however this represents a fifth consecutive quarter of slowed growth. The sandwich (+2.6%) and coffee/snack (+2.0%) segments also posted modest growth led by industry leaders McDonald's (+5.7%) and Starbucks (+7.0%), respectively.

Fast Casual: Results for fast casual concepts were polarized in Q2, with strong performance for Chipotle (+10.0%), Shake Shack (+3.6%) and Noodles & Company (+4.6%), and substantial losses for Fuddruckers (-6.1%), and Potbelly (-4.0%). On average, sales were slightly positive (+1.3%) for the segment.

Family Dining: Family dining broke its positive streak of YOY growth with a slight decrease of (-0.2%) with strong results for Denny's (+3.8%) offset by another weak quarter for Steak n Shake (-5.9%), which turned in the worst results in the segment for the 5th consecutive quarter and extended its losing streak to 11 quarters.

Casual Dining: The casual dining segment posted positive quarterly results for the seventh consecutive quarter with SSS growth of 0.6%. Texas Roadhouse (+4.7%) led the segment marking its 38th consecutive positive quarter. Other strong performers included BJ's (+2.0%), which also produced strong results in every quarter of 2018, and Olive Garden (+2.4%), which has consistently outperformed the segment, Texas Roadhouse excluded, over the past few years. On the other hand, Red Robin posted its 6th straight quarter of negative SSS (-1.5%).

Fine Dining: Nearly all fine dining concepts that report SSS served up positive results in Q2, as the segment continues to outperform with a 1.7% average SSS increase. Capital Grille (+2.9%) and Flemings (+1.6%) led the pack, while Ruth's Chris (-0.5%) and Del Frisco's Grille (-0.6%) performed below expectations. Fine dining steak chains continued to be outperformed by casual steak chains in Q2 2019.

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

RESTAURANT SAME-STORE SALES DATA

November 2019

TRINITY CAPITAL
INVESTMENT BANKING

Same-Store Sales Data

	FY 2016		FY 2017				FY 2018				FY 2019	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
QSR												
Chicken												
Bojangles [1]	0.8%	2.4%	(1.7%)	(1.4%)	(2.2%)	(3.1%)	(0.6%)	(0.2%)	0.4%	N/A	N/A	N/A
KFC	6.0%	4.0%	2.0%	2.0%	1.0%	1.0%	0.0%	1.0%	1.0%	1.0%	2.0%	2.0%
Pollo Tropical	(1.0%)	(4.0%)	(6.7%)	(7.7%)	(10.9%)	(0.1%)	2.8%	3.4%	6.5%	(1.9%)	(2.6%)	(1.3%)
Popeye's	1.5%	3.0%	(0.4%)	(3.3%)	(2.6%)	(2.5%)	2.3%	1.8%	(0.2%)	(0.1%)	0.4%	2.9%
Mean	**1.8%**	**1.4%**	**(1.7%)**	**(2.6%)**	**(3.7%)**	**(1.2%)**	**1.1%**	**1.5%**	**1.9%**	**(0.3%)**	**(0.1%)**	**1.2%**
Coffee/Snack												
Baskin Robbins	(0.9%)	0.9%	(2.4%)	(0.9%)	0.4%	5.1%	(1.0%)	(4.0%)	1.8%	(3.7%)	(2.8%)	(1.4%)
Dunkin Donuts	2.0%	1.9%	0.0%	0.8%	0.6%	0.8%	(0.5%)	1.4%	1.3%	0.0%	2.4%	1.7%
Jamba Juice [2]	(1.1%)	(2.2%)	(5.8%)	0.0%	N/A	2.9%	2.3%	2.4%	N/A	N/A	N/A	N/A
Starbucks	4.0%	3.0%	3.0%	5.0%	2.0%	2.0%	2.0%	1.0%	4.0%	4.0%	4.0%	7.0%
Tim Horton's	4.5%	3.6%	(0.1%)	(0.8%)	0.3%	0.1%	0.1%	0.0%	0.6%	1.9%	(0.6%)	0.5%
Mean	**1.7%**	**1.4%**	**(1.1%)**	**0.8%**	**0.8%**	**2.2%**	**0.6%**	**0.2%**	**1.9%**	**0.6%**	**0.8%**	**2.0%**
Mexican												
Del Taco	6.7%	5.5%	4.2%	7.1%	4.1%	2.4%	3.7%	3.3%	1.4%	1.9%	(0.1%)	2.2%
Taco Bell	3.0%	3.0%	8.0%	4.0%	3.0%	2.0%	1.0%	1.9%	5.0%	6.0%	4.0%	7.0%
Mean	**4.9%**	**4.3%**	**6.1%**	**5.6%**	**3.6%**	**2.2%**	**2.4%**	**2.6%**	**2.8%**	**2.8%**	**2.0%**	**3.7%**
Pizza												
Domino's	13.0%	12.2%	10.2%	9.5%	8.4%	4.2%	8.3%	6.9%	6.3%	5.6%	3.9%	3.0%
Papa John's	5.5%	3.8%	2.0%	1.4%	1.0%	(3.9%)	(5.3%)	(6.1%)	(9.8%)	(8.1%)	(6.9%)	(5.7%)
Papa Murphy's	(5.8%)	(7.8%)	(5.0%)	(4.3%)	(4.1%)	(2.6%)	(3.9%)	(2.4%)	(2.1%)	(1.3%)	N/A	0.0%
Pizza Hut	(2.0%)	(4.0%)	(7.0%)	(3.0%)	0.0%	2.0%	4.0%	0.0%	1.0%	1.0%	0.0%	2.0%
Pizza Inn	0.2%	(1.2%)	0.1%	(9.5%)	1.4%	2.7%	2.3%	2.5%	2.3%	2.7%	3.3%	0.0%
Mean	**2.2%**	**0.6%**	**0.1%**	**(1.2%)**	**1.3%**	**0.5%**	**1.1%**	**0.2%**	**(0.5%)**	**(0.0%)**	**0.1%**	**(0.1%)**
Sandwich												
Burger King	(0.5%)	1.8%	(2.2%)	3.0%	4.0%	5.1%	4.2%	1.8%	(0.7%)	0.8%	0.4%	0.5%
Jack in the Box	2.0%	3.1%	(0.8%)	(0.2%)	(1.0%)	(0.2%)	(0.1%)	0.5%	0.5%	(0.1%)	0.2%	2.7%
McDonald's	1.3%	(1.3%)	1.7%	3.9%	4.1%	4.5%	2.9%	2.6%	2.4%	2.3%	4.5%	5.7%
Sonic Drive-In [3]	(2.0%)	(2.0%)	(7.4%)	(1.2%)	(3.3%)	(1.7%)	(2.9%)	(0.2%)	2.6%	N/A	N/A	N/A
Wendy's	1.4%	0.8%	1.6%	3.2%	2.0%	1.3%	1.6%	1.9%	(0.2%)	0.2%	1.3%	1.4%
Mean	**0.4%**	**0.5%**	**(1.4%)**	**1.7%**	**1.2%**	**1.8%**	**1.1%**	**1.3%**	**0.9%**	**0.8%**	**1.6%**	**2.6%**
Mean Total QSR	**1.8%**	**1.3%**	**(0.3%)**	**0.4%**	**0.4%**	**1.0%**	**1.1%**	**0.9%**	**1.2%**	**0.7%**	**0.8%**	**1.7%**
Fast Casual												
Chipotle	(21.9%)	(4.8%)	17.8%	8.1%	1.0%	0.9%	2.2%	3.3%	4.4%	6.1%	9.9%	10.0%
El Pollo Loco	1.6%	(1.3%)	(0.3%)	2.9%	1.7%	1.4%	(1.1%)	(0.9%)	2.6%	4.4%	2.4%	0.7%
Fuddrucker's	(0.8%)	(1.6%)	(1.1%)	(0.9%)	(3.6%)	0.6%	0.6%	(5.8%)	(3.9%)	(11.2%)	(5.3%)	(6.1%)
Noodles & Company	(0.7%)	(1.3%)	(2.0%)	(3.4%)	(3.5%)	(0.9%)	(0.2%)	5.4%	5.5%	4.0%	3.0%	4.6%
Pie Five	(14.7%)	(17.4%)	(15.8%)	(16.2%)	(17.3%)	(13.7%)	(12.6%)	(6.4%)	(1.8%)	(3.6%)	(4.4%)	0.0%
Potbelly	0.6%	0.1%	(3.1%)	(4.9%)	(4.8%)	(2.4%)	(3.6%)	(0.2%)	(0.2%)	(1.7%)	(4.7%)	(4.0%)
Shake Shack	2.9%	1.6%	(2.5%)	(1.8%)	(1.6%)	0.8%	1.7%	1.1%	(0.7%)	2.3%	3.6%	3.6%
Zoe's Kitchen [4]	2.4%	0.7%	(3.3%)	(3.8%)	(0.5%)	0.3%	(1.5%)	(2.5%)	(7.6%)	N/A	N/A	N/A
Mean	**(3.8%)**	**(3.0%)**	**(1.3%)**	**(2.5%)**	**(3.6%)**	**(1.6%)**	**(1.8%)**	**(0.8%)**	**(0.2%)**	**0.0%**	**0.6%**	**1.3%**

(1) Bojangles was taken private by Durational Capital Management and Jordan Co in Q4 2018

(2) Jamba Juice was taken private by Focus Brands, a portfolio company of Roark Capital, in Q3 2018

(3) Sonic Drive-In was taken private by Inspire Brands, a portfolio company of Roark Capital, in Q4 2018

(4) Zoe's Kitchen was taken private by Cava Group in Q4 2018

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

Same-Store Sales Data (Cont.)

	FY 2016		FY 2017				FY 2018				FY 2019	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Family Dining												
Chuck E Cheese	3.7%	(1.6%)	(2.8%)	(3.8%)	(6.9%)	(6.0%)	(5.1%)	1.0%	2.2%	3.3%	7.7%	0.5%
Cracker Barrel	1.3%	0.6%	(0.4%)	(0.8%)	0.2%	1.1%	1.5%	(2.6%)	1.4%	3.8%	1.3%	1.3%
Denny's	1.0%	0.5%	(1.1%)	2.6%	0.6%	2.2%	1.5%	(0.7%)	1.0%	1.4%	1.3%	3.8%
IHOP	(0.1%)	(2.1%)	(1.7%)	(2.6%)	(3.2%)	(0.4%)	1.0%	0.7%	1.2%	3.0%	1.2%	2.0%
Luby's	0.0%	(2.2%)	(4.4%)	(2.5%)	(4.5%)	1.5%	1.5%	2.4%	3.9%	(3.0%)	(2.2%)	(3.1%)
Steak n Shake	0.2%	(0.4%)	(3.3%)	(3.1%)	(2.2%)	(1.8%)	(1.7%)	(3.4%)	(6.9%)	(5.1%)	(7.9%)	(5.9%)
Mean	**1.0%**	**(0.9%)**	**(2.3%)**	**(1.7%)**	**(2.7%)**	**(0.6%)**	**(0.2%)**	**(0.4%)**	**0.5%**	**0.6%**	**0.2%**	**(0.2%)**
Casual Dining												
Applebee's	(5.2%)	(7.2%)	(7.9%)	(6.2%)	(7.7%)	1.3%	3.3%	5.7%	7.7%	3.5%	1.8%	(0.5%)
Bahama Breeze	3.9%	2.6%	0.5%	1.4%	1.2%	2.5%	0.2%	0.6%	1.1%	(1.1%)	(3.7%)	1.9%
BJ's Restaurants	(3.4%)	(2.2%)	(1.3%)	(1.4%)	(1.7%)	1.6%	4.2%	5.6%	6.9%	4.5%	2.0%	2.0%
Bonefish	1.7%	(1.9%)	(0.8%)	(2.6%)	(4.3%)	0.6%	0.9%	1.5%	1.8%	(1.1%)	1.9%	0.1%
Carrabba's Italian Grill	(2.1%)	(2.3%)	(3.8%)	0.4%	(2.8%)	1.3%	0.9%	(0.6%)	(0.6%)	0.8%	0.3%	(1.6%)
Cheesecake Factory	1.7%	1.1%	0.3%	(0.5%)	(2.3%)	(0.9%)	2.1%	1.4%	1.5%	1.9%	1.3%	1.0%
Chili's Grill & Bar	(1.3%)	(3.2%)	(1.7%)	(1.7%)	(3.0%)	(1.6%)	(1.1%)	0.4%	1.9%	3.0%	2.7%	1.3%
Chuy's	0.3%	(1.1%)	(0.7%)	(1.0%)	(2.1%)	1.3%	(1.5%)	1.0%	0.5%	0.9%	3.2%	1.9%
Dave & Buster's	5.9%	3.2%	2.2%	1.1%	(1.3%)	(5.9%)	(4.9%)	(2.4%)	(1.3%)	2.9%	(0.3%)	(3.3%)
Famous Dave's	(3.8%)	(4.7%)	(4.8%)	(3.2%)	(1.5%)	1.8%	(0.9%)	(1.6%)	(1.4%)	(1.5%)	(0.7%)	0.4%
LongHorn Steakhouse	0.6%	0.1%	0.2%	3.5%	2.6%	3.8%	2.0%	2.4%	3.1%	2.9%	3.8%	3.3%
Maggiano's	(0.6%)	(0.8%)	1.6%	0.5%	(2.6%)	1.8%	0.5%	0.3%	0.0%	1.8%	0.4%	(0.2%)
Olive Garden	2.0%	2.6%	1.4%	4.4%	1.9%	3.0%	2.2%	2.4%	5.3%	3.5%	4.3%	2.4%
Outback	(0.7%)	(4.8%)	1.4%	0.3%	0.6%	4.7%	4.3%	4.0%	4.6%	2.9%	3.5%	1.3%
Red Robin	(3.3%)	(4.4%)	(1.5%)	0.5%	(0.1%)	2.7%	(0.9%)	(2.6%)	(3.4%)	(4.5%)	(3.3%)	(1.5%)
Taco Cabana	(4.1%)	(3.5%)	(4.5%)	(4.7%)	(12.6%)	(7.4%)	0.9%	3.1%	12.2%	5.1%	(0.5%)	(3.0%)
Texas Roadhouse	3.4%	1.4%	3.2%	4.0%	4.5%	5.8%	4.9%	5.7%	5.5%	5.6%	5.2%	4.7%
Mean	**(0.2%)**	**(1.6%)**	**(1.1%)**	**(0.6%)**	**(2.1%)**	**0.6%**	**0.5%**	**0.8%**	**1.7%**	**1.8%**	**1.3%**	**0.6%**
Fine Dining												
Fleming's	(1.9%)	0.2%	(2.9%)	(1.3%)	(1.0%)	3.1%	2.9%	0.3%	0.5%	(0.4%)	0.6%	1.6%
Ruth's Chris	2.1%	0.0%	0.7%	2.9%	(1.6%)	1.5%	1.1%	1.3%	3.7%	(0.1%)	1.8%	(0.5%)
Capital Grille	(1.2%)	1.2%	0.9%	0.5%	2.0%	3.8%	2.8%	2.6%	3.9%	3.7%	4.3%	2.9%
Del Frisco's Grille	(1.4%)	2.7%	(0.9%)	(3.2%)	(5.4%)	0.9%	(1.4%)	0.7%	(0.4%)	(0.8%)	0.2%	(0.6%)
Sullivan's	(3.2%)	0.9%	1.1%	(5.2%)	7.7%	(10.8%)	(10.3%)	(6.0%)	N/A	N/A	N/A	N/A
Mean	**(1.1%)**	**1.0%**	**(0.2%)**	**(1.3%)**	**0.3%**	**(0.3%)**	**(1.0%)**	**(0.2%)**	**1.9%**	**0.6%**	**1.7%**	**0.9%**

(1) Sullivan's was taken private by Romano's Macaroni Grill in Q3 2018

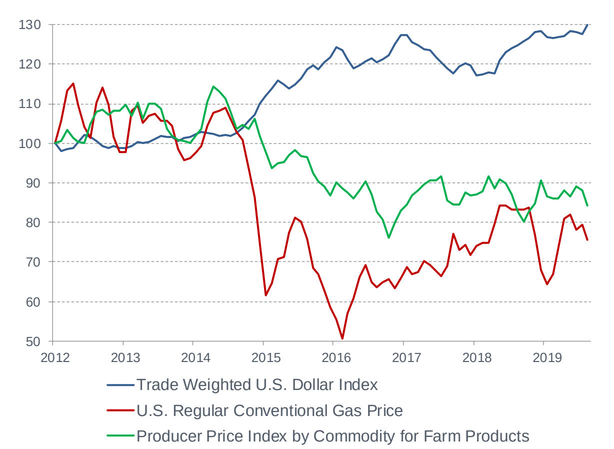
Source: Restaurant Research LLC, Capital IQ, Technomic and company filings

Navigating Profitability in a Challenging Environment

Many restaurant operators are facing mounting external pressures to their EBITDA margins and free cash flow. The potential for a slowing economy, weakening dollar, and franchisor development demands are just a few factors lingering in the minds of operators. The ultimate question will become at what point are margins too narrow to be sustainable or unattractive to outside investors?

A few years ago, when labor pressures were mounting from mandated minimum wage increases along with elevated commodity prices, operators were facing significant downward pressures to their profitability. Since that point, the U.S. dollar began to strengthen (see chart below) and provided an environment for business owners to withstand the initial shock. In addition to the commodity relief, many operators were able to couple this with price increases to mitigate nearly all the potential margin loss from labor increases.

U.S. Dollar vs. Commodity Prices

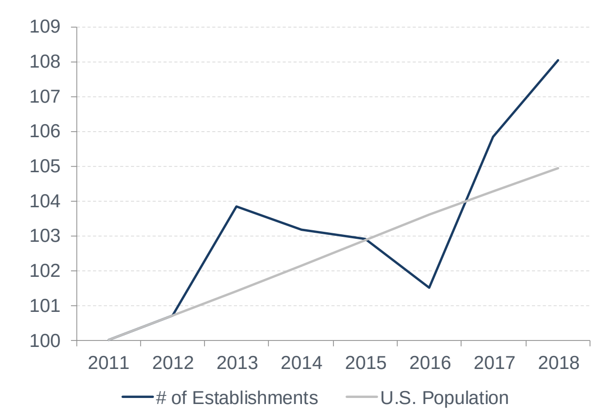


Source: St. Louis Federal Reserve (FRED Economic Data)

As we look fast forward to today, operators may have solved (at least temporarily) the labor part of the equation but are now facing new challenges to their P&Ls. Competitive pressures from rapidly changing consumer demands, rising deferred capital expenditures and cannibalizing new unit development are among the new issues to be addressed by operators.

For example, one of the overarching pressures is that many franchisors have been forced to overdevelop restaurants to maintain pace with the competition and appease their stakeholders. As a result, the number of new establishments has significantly outpaced population growth since 2011, diminishing traffic per restaurant (see next chart). Without a reset or reversion of unit count to the population growth, profitability at existing restaurants wanes without an external catalyst event.

Indexed Restaurant Growth vs. U.S. Population



Source: Statista, St. Louis Federal Reserve (FRED Economic Data)

Moving beyond EBITDA margins which many people tend to solely measure profitability, savvy restaurant operators and investors will be laser-focused on free cash flow as the true metric of profitability. This is because EBITDA ignores debt service (both principal and interest), cash taxes, and capital expenditures (maintenance, remodel and new unit development.) All these items are true costs of doing business but do not get captured in P&L accounting at the restaurant level. Keeping a close eye on free cash flow as a % of sales and overall cushion is critical for ongoing success.

We live in an environment where information moves seamlessly, technological advances are rapid and consumer preferences can pivot to another concept or trend almost instantaneously. For example, if the trade war persists and the dollar weakens, commodity prices could come under pressure leaving low-margin operators vulnerable to cash flow issues.

All in all, amidst the growing challenges due to margin compression and competition, where do operators go from here? What we do know is that it is important for business owners to regularly evaluate their true costs such as required debt service and capital expenditures and control the costs they can control. Successful operators will be able to navigate all environments and be nimble and proactive in addressing headwinds to their businesses.

Contributing Editor Zach Olson is a Director at Trinity Capital.

Ghost Kitchens: The Next Frontier?

You may be familiar with an emerging trend in the restaurant industry that has attracted significant attention in recent months. So much attention in fact, that investors the likes of Amazon, Google Ventures and the former CEO of Uber have invested hundreds of millions in the nascent segment. Ghost kitchens are taking the country by storm and many believe the business model is here to stay.

What is a ghost kitchen? A ghost kitchen refers to a kitchen, typically in a shared space, that is set up to make food intended for delivery-only and does not include a storefront or dining area. The concept of a ghost kitchen emerged through the confluence of multiple recent developments in the restaurant industry. First, the restaurant industry is experiencing a booming delivery business. Customers seeking more convenient food options spent $10.2 billion on delivery services in 2018, up 42% from the previous year, according to Technomic data. The second factor impacting the restaurant industry is limited real estate and high construction costs. It's getting harder and harder for large national chains, as well as single unit operators, to find suitable real estate to open new restaurants. Lastly, related to the boom in delivery, the fees (as high as 30% of the order) that third-party delivery aggregators such as UberEats and GrubHub impose eat into profitability and may not be sustainable for restaurant operators at current levels. With the pressures on the P&L due in part to the increase in delivery sales, ghost kitchens are surfacing as a viable solution that can benefit national chains and mom and pop operators alike.

Currently, there are only a handful of ghost kitchen companies, but we anticipate more entrants will be drawn to this burgeoning sector. Some of the more recognizable names include CloudKitchens, Kitchen United, and Zuul. Deliveroo, based in the UK, is primarily a food delivery company, but has also opened multiple ghost kitchens of their own. As shown in the table to the right, several of these companies are backed by venture capital firms and large institutions seeking aggressive growth in this uncharted territory.

What does all this mean for the restaurant owner? In the short-term, ghost kitchens will provide a cost-efficient, low risk alternative to the traditional brick-and-mortar restaurant. Many national chains are considering the prospect of utilizing a shared kitchen, and brands including like Sweetgreen, Famous Dave's and Chick-fil-A have already begun experimenting with shared kitchen space. By utilizing ghost kitchens, restaurants can generate higher margins due to the cost savings from lower labor, rent, utilities and other operating expenses. Another advantage is the ability to rent a shared kitchen space in an area that is underserved by the brand. New York City is a prime example of an area where ghost kitchens can be very disruptive. New York City is one of the most densely populated cities in the world which typically corresponds with very expensive real estate. This factor alone can deter or entirely prohibit a restauranteur from opening a storefront. Instead, by renting a shared kitchen, a brand can penetrate the DMA in a very cost-efficient way and gain access to a large number of unserved customers. Ghost kitchens can also serve as a satellite kitchen for restaurants that experience an overflow of delivery orders.

Ghost Kitchen Companies and Investors

Company	Region	Investors	Amount (Date)
CloudKitchens	US	Travis Kalanick	$150MM (Mar 18)
Deliveroo	UK	Amazon	$575MM (May 19)
Fulton Kitchens	Los Angeles	n/a	n/a
Kitchens United	US	Google Ventures, RXR	$40MM Series B (Sep 19)
Zuul Kitchens	NYC	n/a	n/a

Source: Company reports and press releases

The shared kitchen phenomenon is also enabling restaurant startups to open a business without tying themselves to a long-term lease or investing significant capital. A restauranteur with a novel concept or unique food offering will be able to enter the market quickly and with a relatively low initial investment. This will lower the barriers to entry and result in greater choice for the consumer at lower prices.

While the initial impact of ghost kitchens may be positive for traditional brands and small operators, the long-term impact is uncertain. Big companies such as Amazon, Alphabet (Google's parent company) and Uber are investing heavily in this trend which will lead to increased competition. Some believe that this type of corporate investment may lead to the eventual demise of the independent restaurant owner and could potentially cut into grocery store revenue. The purpose of ghost kitchens is to make it cheaper and faster to order delivery, and if they succeed, restaurant operators and grocery stores will likely lose market share.

We believe it is prudent for any restaurant owner to monitor this trend and to position themselves to take advantage of the potential benefits.

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