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A DIVISION OF CITIZENS CAPITAL MARKETS

RESTAURANT INDUSTRY COMMENTARY & SAME-STORE SALES DATA

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Inside This Issue

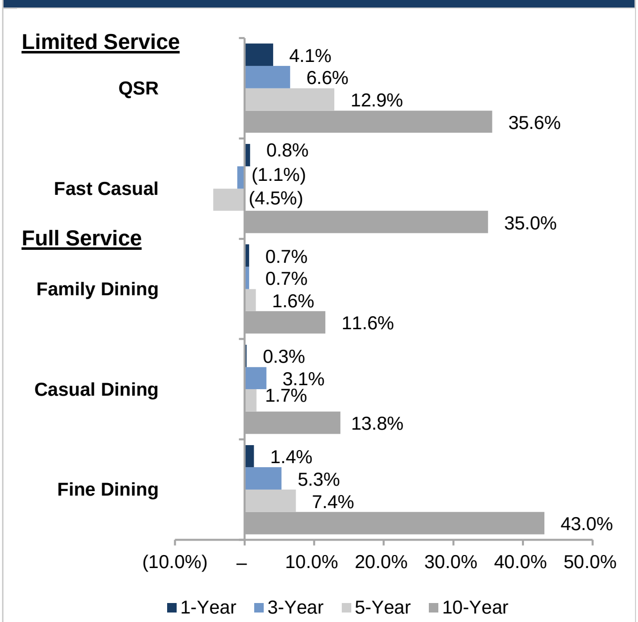
Published: April 2020

Same-Store Sales Discussion

Restaurant industry same-store sales ("SSS") increased for the ninth straight quarter in Q4 2019 following six consecutive quarters of SSS declines. Of the 50 companies reporting SSS results this quarter, 40, or 80.0%, 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 (+43.0%); however, the segment was hit hardest by the Great Recession, so the starting point was also the lowest. QSR led the industry with 4.1% growth in Q4 2019.

Cumulative Q4 2019 SSS by Segment



Source: Company filings; Technomic, Inc.

QSR: The QSR segment extended its streak of positive year-over-year ("YOY") SSS growth with a 4.1% increase. Chicken concepts led the segment for the first time since Q4 2014 with 13.2% growth. This performance was almost entirely driven by Popeyes' eye-popping 37.9% same store sales growth, resulting from its viral chicken sandwich release. Burger concepts delivered another positive result in Q4 with a 2.9% increase, driven by strong performances from McDonald's (+5.1%) and Wendy's (+4.3%). The Pizza segment increased 1.3% for the quarter led by Papa John's (+3.5%) for the first time in more than five years and partially offset by Pizza Hut's (-4.0%) second consecutive quarterly decline. Domino's (+3.4%) delivered another strong quarter in Q4, its 35th consecutive positive quarter. The Mexican (+2.2%) and coffee/snack (+2.2%) 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 again in Q4, with strong performance for Chipotle (+13.4%), El Pollo Loco (+3.9%) and Noodles & Company (+2.8%), partially offset by Pie Five (-11.0%) and Shake Shack (-3.6%). On average, sales were slightly positive (0.8%) for the segment.

Family Dining: Family dining saw its first YOY SSS increase in two quarters (+0.7%) with strong results for Cracker Barrel (+3.8%), partially offset by another weak quarter for Steak n Shake (-6.9%), which turned in the weakest results in the segment for the seventh consecutive quarter and extended its losing streak to 13 quarters.

Casual Dining: The casual dining segment was slightly positive (0.3%) for the quarter. This marks its ninth consecutive quarter without a decrease in comp sales. Texas Roadhouse (+4.4%) led the segment with its 40th consecutive positive quarter. Other strong performers included Longhorn Steakhouse (+6.7%) and Chuy's (+2.9%). Outback Steakhouse (+2.7%) and Red Robin (+1.3%) both also recorded strong quarters, while Taco Cabana (-8.1%) Dave & Buster's (-4.4%), and Bahama Breeze (-3.4%) lagged the segment.

Fine Dining: Every fine dining concept that reported SSS in Q4 served up positive results for the second consecutive quarter, as the segment continued to perform well with a 1.4% average SSS increase. Capital Grille (+1.8%) led the pack, with Fleming's (+0.9%) and Ruth's Chris (+1.4%) posting increases as well. Additionally, fine dining steak chains continued to be outperformed by casual steak chains in Q4 2019.

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

RESTAURANT SAME-STORE SALES DATA

April 2020

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Same-Store Sales Data

	FY 2017				FY 2018				FY 2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
QSR												
Chicken												
KFC	2.0%	2.0%	1.0%	1.0%	0.0%	1.0%	1.0%	1.0%	2.0%	2.0%	(1.0%)	1.0%
Pollo Tropical	(6.7%)	(7.7%)	(10.9%)	(0.1%)	2.8%	3.4%	6.5%	(1.9%)	(2.6%)	(1.3%)	(3.8%)	0.6%
Popeyes	(0.4%)	(3.3%)	(2.6%)	(2.5%)	2.3%	1.8%	(0.2%)	(0.1%)	0.4%	2.9%	10.2%	37.9%
Mean	**(1.7%)**	**(3.0%)**	**(4.2%)**	**(0.5%)**	**1.7%**	**2.1%**	**2.4%**	**(0.3%)**	**(0.1%)**	**1.2%**	**1.8%**	**13.2%**
Coffee/Snack												
Baskin Robbins	(2.4%)	(0.9%)	0.4%	5.1%	(1.0%)	(4.0%)	1.8%	(3.7%)	(2.8%)	(1.4%)	3.6%	4.1%
Dunkin Donuts	0.0%	0.8%	0.6%	0.8%	(0.5%)	1.4%	1.3%	0.0%	2.4%	1.7%	1.5%	2.8%
Starbucks	3.0%	5.0%	2.0%	2.0%	2.0%	1.0%	4.0%	4.0%	4.0%	7.0%	6.0%	6.0%
Tim Horton's	(0.1%)	(0.8%)	0.3%	0.1%	0.1%	0.0%	0.6%	1.9%	(0.6%)	0.5%	(1.4%)	(4.3%)
Mean	**0.1%**	**1.0%**	**0.8%**	**2.0%**	**0.2%**	**(0.4%)**	**1.9%**	**0.6%**	**0.8%**	**2.0%**	**2.4%**	**2.2%**
Mexican												
Del Taco	4.2%	7.1%	4.1%	2.4%	3.7%	3.3%	1.4%	1.9%	(0.1%)	2.2%	1.0%	0.4%
Taco Bell	8.0%	4.0%	3.0%	2.0%	1.0%	1.9%	5.0%	6.0%	4.0%	7.0%	4.0%	4.0%
Mean	**6.1%**	**5.6%**	**3.6%**	**2.2%**	**2.4%**	**2.6%**	**3.2%**	**4.0%**	**2.0%**	**4.6%**	**2.5%**	**2.2%**
Pizza												
Domino's	10.2%	9.5%	8.4%	4.2%	8.3%	6.9%	6.3%	5.6%	3.9%	3.0%	2.4%	3.4%
Papa John's	2.0%	1.4%	1.0%	(3.9%)	(5.3%)	(6.1%)	(9.8%)	(8.1%)	(6.9%)	(5.7%)	1.0%	3.5%
Pizza Hut	(7.0%)	(3.0%)	0.0%	2.0%	4.0%	0.0%	1.0%	1.0%	0.0%	2.0%	(3.0%)	(4.0%)
Pizza Inn	0.1%	(9.5%)	1.4%	2.7%	2.3%	2.5%	2.3%	2.7%	3.3%	0.0%	3.1%	2.4%
Mean	**1.3%**	**(0.4%)**	**2.7%**	**1.3%**	**2.3%**	**0.8%**	**(0.1%)**	**0.3%**	**0.1%**	**(0.2%)**	**0.9%**	**1.3%**
Burger												
Burger King	(2.2%)	3.0%	4.0%	5.1%	4.2%	1.8%	(0.7%)	0.8%	0.4%	0.5%	5.0%	0.6%
Jack in the Box	(0.8%)	(0.2%)	(1.0%)	(0.2%)	(0.1%)	0.5%	0.5%	(0.1%)	0.2%	2.7%	3.0%	1.7%
McDonald's	1.7%	3.9%	4.1%	4.5%	2.9%	2.6%	2.4%	2.3%	4.5%	5.7%	4.8%	5.1%
Wendy's	1.6%	3.2%	2.0%	1.3%	1.6%	1.9%	(0.2%)	0.2%	1.3%	1.4%	4.4%	4.3%
Mean	**0.1%**	**2.5%**	**2.3%**	**2.7%**	**2.2%**	**1.7%**	**0.5%**	**0.8%**	**1.6%**	**2.6%**	**4.3%**	**2.9%**
Mean Total QSR	**0.8%**	**0.9%**	**1.0%**	**1.6%**	**1.7%**	**1.2%**	**1.4%**	**0.8%**	**0.8%**	**1.8%**	**2.4%**	**4.1%**
Fast Casual												
Chipotle	17.8%	8.1%	1.0%	0.9%	2.2%	3.3%	4.4%	6.1%	9.9%	10.0%	11.0%	13.4%
El Pollo Loco	(0.3%)	2.9%	1.7%	1.4%	(1.1%)	(0.9%)	2.6%	4.4%	2.4%	0.7%	1.1%	3.9%
Fuddrucker's	(1.1%)	(0.9%)	(3.6%)	0.6%	0.6%	(5.8%)	(3.9%)	(11.2%)	(5.3%)	(6.1%)	(5.5%)	0.1%
Noodles & Company	(2.0%)	(3.4%)	(3.5%)	(0.9%)	(0.2%)	5.4%	5.5%	4.0%	3.0%	4.6%	2.1%	2.8%
Pie Five	(15.8%)	(16.2%)	(17.3%)	(13.7%)	(12.6%)	(6.4%)	(1.8%)	(3.6%)	(4.4%)	0.0%	(12.2%)	(11.0%)
Potbelly	(3.1%)	(4.9%)	(4.8%)	(2.4%)	(3.6%)	(0.2%)	(0.2%)	(1.7%)	(4.7%)	(4.0%)	(3.0%)	0.1%
Shake Shack	(2.5%)	(1.8%)	(1.6%)	0.8%	1.7%	1.1%	(0.7%)	2.3%	3.6%	3.6%	2.0%	(3.6%)
Mean	**(1.0%)**	**(2.3%)**	**(4.0%)**	**(1.9%)**	**(1.9%)**	**(0.5%)**	**0.8%**	**0.0%**	**0.6%**	**1.3%**	**(0.6%)**	**0.8%**

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

Same-Store Sales Data (Cont.)

	FY 2017				FY 2018				FY 2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Family Dining												
Chuck E Cheese	(2.8%)	(3.8%)	(6.9%)	(6.0%)	(5.1%)	1.0%	2.2%	3.3%	7.7%	0.5%	(0.9%)	2.6%
Cracker Barrel	(0.4%)	(0.8%)	0.2%	1.1%	1.5%	(2.6%)	1.4%	3.8%	1.3%	1.3%	2.1%	3.8%
Denny's	(1.1%)	2.6%	0.6%	2.2%	1.5%	(0.7%)	1.0%	1.4%	1.3%	3.8%	1.1%	1.7%
IHOP	(1.7%)	(2.6%)	(3.2%)	(0.4%)	1.0%	0.7%	1.2%	3.0%	1.2%	2.0%	0.0%	1.1%
Luby's	(4.4%)	(2.5%)	(4.5%)	1.5%	1.5%	2.4%	3.9%	(3.0%)	(2.2%)	(3.1%)	(3.2%)	1.7%
Steak n Shake	(3.3%)	(3.1%)	(2.2%)	(1.8%)	(1.7%)	(3.4%)	(6.9%)	(5.1%)	(7.9%)	(5.9%)	(6.5%)	(6.9%)
Mean	**(2.3%)**	**(1.7%)**	**(2.7%)**	**(0.6%)**	**(0.2%)**	**(0.4%)**	**0.5%**	**0.6%**	**0.2%**	**(0.2%)**	**(1.2%)**	**0.7%**
Casual Dining												
Applebee's	(7.9%)	(6.2%)	(7.7%)	1.3%	3.3%	5.7%	7.7%	3.5%	1.8%	(0.5%)	(1.6%)	(2.5%)
Bahama Breeze	0.5%	1.4%	1.2%	2.5%	0.2%	0.6%	1.1%	(1.1%)	(3.7%)	1.9%	(4.2%)	(3.4%)
BJ's Restaurants	(1.3%)	(1.4%)	(1.7%)	1.6%	4.2%	5.6%	6.9%	4.5%	2.0%	2.0%	(0.3%)	0.4%
Bonefish	(0.8%)	(2.6%)	(4.3%)	0.6%	0.9%	1.5%	1.8%	(1.1%)	1.9%	0.1%	(2.2%)	0.5%
Carrabba's Italian Grill	(3.8%)	0.4%	(2.8%)	1.3%	0.9%	(0.6%)	(0.6%)	0.8%	0.3%	(1.6%)	0.1%	1.4%
Cheesecake Factory	0.3%	(0.5%)	(2.3%)	(0.9%)	2.1%	1.4%	1.5%	1.9%	1.3%	1.0%	0.4%	0.6%
Chili's Grill & Bar	(1.7%)	(1.7%)	(3.0%)	(1.6%)	(1.1%)	0.4%	1.9%	3.0%	2.7%	1.3%	2.3%	1.7%
Chuy's	(0.7%)	(1.0%)	(2.1%)	1.3%	(1.5%)	1.0%	0.5%	0.9%	3.2%	1.9%	2.6%	2.9%
Dave & Buster's	2.2%	1.1%	(1.3%)	(5.9%)	(4.9%)	(2.4%)	(1.3%)	2.9%	(0.3%)	(3.3%)	(3.2%)	(4.4%)
Famous Dave's	(4.8%)	(3.2%)	(1.5%)	1.8%	(0.9%)	(1.6%)	(1.4%)	(1.5%)	(0.7%)	0.4%	1.9%	0.9%
LongHorn Steakhouse	0.2%	3.5%	2.6%	3.8%	2.0%	2.4%	3.1%	2.9%	3.8%	3.3%	2.6%	6.7%
Maggiano's	1.6%	0.5%	(2.6%)	1.8%	0.5%	0.3%	0.0%	1.8%	0.4%	(0.2%)	(1.8%)	(1.4%)
Olive Garden	1.4%	4.4%	1.9%	3.0%	2.2%	2.4%	5.3%	3.5%	4.3%	2.4%	2.2%	1.5%
Outback	1.4%	0.3%	0.6%	4.7%	4.3%	4.0%	4.6%	2.9%	3.5%	1.3%	0.2%	2.7%
Red Robin	(1.5%)	0.5%	(0.1%)	2.7%	(0.9%)	(2.6%)	(3.4%)	(4.5%)	(3.3%)	(1.5%)	1.6%	1.3%
Taco Cabana	(4.5%)	(4.7%)	(12.6%)	(7.4%)	0.9%	3.1%	12.2%	5.1%	(0.5%)	(3.0%)	(4.8%)	(8.1%)
Texas Roadhouse	3.2%	4.0%	4.5%	5.8%	4.9%	5.7%	5.5%	5.6%	5.2%	4.7%	4.4%	4.4%
Mean	**(1.0%)**	**(0.3%)**	**(1.8%)**	**1.0%**	**1.0%**	**1.6%**	**2.7%**	**1.8%**	**1.3%**	**0.6%**	**0.0%**	**0.3%**
Fine Dining												
Fleming's	(2.9%)	(1.3%)	(1.0%)	3.1%	2.9%	0.3%	0.5%	(0.4%)	0.6%	1.6%	0.4%	0.9%
Ruth's Chris	0.7%	2.9%	(1.6%)	1.5%	1.1%	1.3%	3.7%	(0.1%)	1.8%	(0.5%)	0.6%	1.4%
Capital Grille	0.9%	0.5%	2.0%	3.8%	2.8%	2.6%	3.9%	3.7%	4.3%	2.9%	1.5%	1.8%
Mean	**(0.4%)**	**0.7%**	**(0.2%)**	**2.8%**	**2.3%**	**1.4%**	**2.7%**	**1.1%**	**2.2%**	**1.3%**	**0.8%**	**1.4%**

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

COVID-19 Impact on the Restaurant Industry and What to Expect

The coronavirus was said to have been initiated in Wuhan, China, sometime in November or December of last year. In February and March, cases started showing up in Washington state, New York City and other locations. Government officials seemed slow to identify the severity and morbidity of this virus; thus, it ran largely unchecked for about three weeks. This was enough to lead to widespread contagion which ultimately has temporarily crippled the US economy. Despite monetary and fiscal stimulus efforts, major US companies have seen a $5 trillion decline in market value marking the most devastating financial event this country has ever faced. The silver lining is that this crisis was not systemic but induced by the government closing businesses to protect public health. If these businesses are reopened quickly enough without sacrificing public safety, much of the employment and other losses can be greatly mitigated.

A total of 42 states with a total population of 316 million have invoked shelter-in-place orders, effectively closing most retail establishments, sporting venues, museums, theaters, churches, synagogues, universities, schools, and non-essential businesses. On March 23, nine states had invoked shelter-in-place orders. By the end of that week 30 states had adopted similar measures. These orders were issued after State and National health professionals reached the consensus that preventing the spread of the disease was best accomplished by social distancing and shelter-in-place regulations. The government is providing massive fiscal and monetary support largely through two legislative programs and the activity of the Federal Reserve. This will ultimately create a $4 trillion deficit this year and keep interest rates low for an extended period of time. The Congressional Budget Office (CBO) projects that interest spending will exceed $800 billion and nearly 3% of GDP by 2027 as a result of rising interest rates and growing debt levels. This will undoubtably attract attention from Moody's and Standard & Poor's and raise questions about the strength of the dollar and the cost of the debt in terms of the annual budget.

The impact of shelter-in-place restrictions on restaurant industry sales has been dramatic but has not been homogeneous among different restaurant sectors and concepts. Dining rooms in 42 states are closed for sit-down meal consumption, relegating the industry exclusively to drive-through, delivery and carry-out service options. According to National Restaurant Association, eight million restaurant employees have been laid off or furloughed, 40% of restaurants are closed and 97% of restaurant operators reported same-store sales declines of 78%, on average. This has decimated fine dining and casual dining as many food types are not as portable and many concepts are not ideally equipped for delivery and takeout. Nonetheless, some chains have done a masterful job at maintaining sales, employees and customers despite the operating difficulty in this environment. Some fine dining chains have elected to close all their stores while others are selling full meals, both cooked and uncooked, meat and other products with unexpectedly good results. Entertainment venues have closed but are surprisingly doing a brisk business offering takeout particularly for the more portable options such as pizzas, sandwiches and salads. There is no better example of American entrepreneurship than restaurant operators who have been working hard to retain employees, bolster going concern, contribute to the economy and feed our citizens.

US Retail Traffic Index

Source: LocateAI

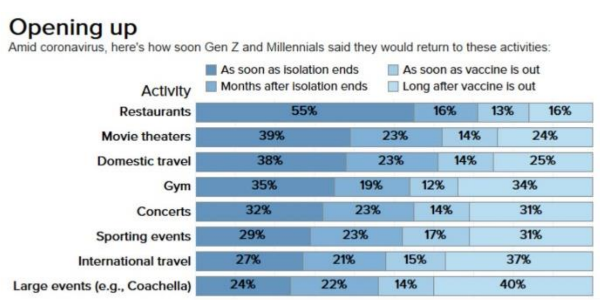
This crisis has favored restaurant concepts that have drive-through capabilities and home meal replacement options for customers. For example, KFC has been marketing a $30 bucket which is an outstanding product for home meal replacement. This option has significantly increased KFC's ticket, customer appeal and bottom-line. In addition, pizza concepts are doing well because they have their own delivery force and do not rely on third-party delivery. Most of the national pizza concepts have weathered this crisis well with positive sales. QSR establishments have also greatly benefited from eliminating less profitable dayparts which limits labor costs. We have heard from operators in some major concepts that are experiencing nearly 200 basis points in P&L cost improvement.

Regional QSR concepts have not fared as well as the majors. They've been forced to make royalty and advertising concessions to franchisees, depleting their ability to promote. These concepts have lower volumes and profitability and cannot absorb the loss of sales as well as the major concepts. In addition, many of these concepts do not have uniformity or drive-through options in all of their locations. Many have closed stores and furloughed employees. Rehiring these employees will present a significant challenge when the states begin to rescind the shelter-in-place orders.

One of the federal programs designed to sustain the economy during the COVID-19 crisis is the Payroll Protection Program which is part of the CARES Act (Coronavirus Aid, Relief & Economic Security). The basics of this program are to create low interest loans which can convert into grants with the satisfaction of some basic conditions. The loans are sized at approximately 2.5 times average monthly payroll up to $10 million. This program has already distributed over $350 billion to small business owners nationwide. However, converting a loan to a grant may not be as easy as anticipated. The federal government has also given a $600 per week temporary subsidy to unemployed workers in addition to the state unemployment payment. Here in California that would be $1,000 per week total which presents a large obstacle to companies trying to attract employees back to work. A $1,000 a week is $25 an hour and QSR employees earn approximately $10 per hour on average nationwide. So, the government has one program which makes it lucrative not to work and another program that pays small businesses payroll subsidies to retain employees. The two programs seem antithetical to one another and may necessitate a fix for the PPP program.

Many restaurant companies are looking forward to the removal of the shelter-in-place orders so they can return to normal levels of sales and traffic. However, there will be a transitional phase where many demographics are very slow to embrace the rescission of the shelter-in-place orders.

Consumer Return to Activities Post-COVID-19



Source: TruePublic, Margin of ereror: +/- 2.37%, April 10-16, 2020

We believe that many demographics will be cautious in returning to public congregating areas such as restaurants, gyms, airports, parks, sporting events, theaters and the like. We strongly believe that octogenarians, septuagenarians, those in poor health, those with high risk conditions such as diabetes, obesity and heart ailments will all be slow to return to public congregating areas. While many people will be joyous to be relieved of cabin fever, concern for individual health and safety will have a larger impact on consumer expenditures than is anticipated. We believe that sales for struggling concepts have performed very poorly during the shelter-in-place orders. Compounding this fact is that most of them have not been able to generate or collect advertising contributions. Consequently, when the shelter-in-place orders are rescinded the major concepts will be heavily promoting value while the weaker concepts may not even be on the air. We believe this will exacerbate the difficulties and lead to an acceleration of concept failures and closures among weaker concepts.

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Restaurant Employment in the Time of COVID-19

In mid-February U.S. stock indices reached all-time highs and restaurants were full of confident customers and were projected to employ 15.6 million people, one in ten working Americans.[1] Only one month later, jurisdiction after jurisdiction ordered a shuttering of restaurant dining rooms and initiated stay at home orders for non-essential workers. Many restaurants shifted to delivery and take out models, but sales have suffered as traffic collapsed. Prior to COVID-19, restaurants were projected to produce nearly $900 billion in sales in 2020, roughly 4% of GDP.[2] As sales have fallen, restaurants have furloughed or laid off employees, many of whom are hourly workers earning an average of $11.33 per hour.[3]

Restaurants and restaurant employees are disproportionately affected by COVID-19 as social distancing remains the only effective measure to control the spread of the disease. Restaurant comp sales and traffic were down 28.3% and 29.2%, respectively, in March.[4] However, this only begins to explain the impact as many jurisdictions did not initiate dining room closures until mid-March. Over half of March's non-farm payroll declines were attributed to the restaurant industry.[5] The survey period only counted part of March, before many areas had yet shut down. According to many states, restaurant workers filed a significant portion of new unemployment claims which also may be under-reported due to the influx of new claims.[6] Currently, unemployment benefits vary by state with a range of maximum benefits from $240 to $1,234 per week and a minimum timeframe of 13 weeks. The stimulus plan will add

[1] *Source: National Restaurant Association*
[2] *Source: National Restaurant Association*
[3] *Source: Indeed.com*
[4] *Source: Black Box Intelligence*
[5] *Source: Restaurant Business Online*
[6] *Source: Department of Labor*

$600 per week to anyone collecting unemployment and will also add 13 weeks on top of the state plan through July 31st.[7]

The return to normal (or perhaps even more likely what will be a new normal) is likely to be gradual and is unlikely to occur in the immediate term. Perhaps office employees will return to work but restaurants are likely to have strict capacity restraints if they are allowed to reopen dining rooms at all. We are likely to see large public gatherings phased in over a much longer timeframe (for example, Los Angeles has prepared to cancel all public gatherings until 2021)[8] and it would not be surprising to see certain demographics exercising caution for a longer period of time.

As new cases of COVID-19 begin to decline in a given region, officials may start the process of re-opening their regional economy which is likely to lead to a race to hire talent to ramp up restaurant operations. High quality employees are likely to be in a position of negotiating power as restaurants compete to hire the best employees since they will be in the unique position to make a "first impression" with their customers. Not only will restaurant owners have to compete for talent with other restaurant operators and other businesses looking for hourly employees; they will also have to compete with employees collecting unemployment. The average restaurant employee makes $11.33 an hour or $453 over a 40 hour work week, substantially less than collecting any level of state unemployment plus the federal $600 per week, not counting ancillary costs such as transportation to work. This is scheduled to end July 31st as of now but it will represent a hurdle to hiring as long as former restaurant employees can make more money while staying at home. To put it in perspective, an average restaurant worker in Arizona that is entitled to receive their state's full benefit package of $240 plus the additional $600 per week annualizes $43,680 versus $23,566 the employee would earn working. In New York, where the employee could collect up to $504 per week the annualized unemployment is $57,408. Restaurants will have to employ several strategies to compete effectively as regional economies reopen.

Restaurants have several ways to compete beyond entering a bidding war with their competitors and unemployment benefits. There are some great benefits to retaining key employees and rehiring former employees given the time and dollars invested in training them. TDn2K estimates that the turnover cost for a restaurant manager is $13,867 while the cost of hiring and training an hourly employee can reach $3,500 according to Investopedia.[9] Restaurants should look to maintain as much of their staff as possible by offering takeout and delivery and using PPP funds so as to avoid having to hire and train a whole new crew as competitors are able to quickly run at full speed. In order to retain employees when a restaurant deems that the best option, the employer should stress to the employee the benefits of maintaining health insurance (especially during a pandemic), contributing to Social Security and their retirements and the ability to step up for potential battlefield promotions. Additionally, if many businesses are unable to weather the downturn, there may not be jobs for everyone come July 31st. For employees that a restaurant is struggling to retain, employers may coax them to return through bonuses and opportunities for faster promotion. Another way to limit cash compensation at the start would be to establish equity-like incentives tied to specific unit performance and customer satisfaction. Retaining employees and rehiring former employees could help restaurants quickly ramp staffing to pre-COVID-19 levels when the time is right.

Restaurants are vital to the economy, providing an essential service to millions of Americans and accounting for over half of household dining dollars. Given the current social distancing and stay-at-home mandates, restaurants and their employees have been especially hard hit by COVID-19 causing restaurants to reduce staffing commensurate with tepid demand. All this will lead to a difficult and competitive process to hire when the economy reopens requiring restaurants to employ creative solutions both then and now to compete in a uniquely difficult situation.

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Impact of COVID-19 on Restaurant Business Model

The COVID-19 pandemic has brought unprecedented challenges to the restaurant industry that few could have imagined, even a few months ago. As operators work to navigate through this period of uncertainty, most are faced with two critical questions. First, what actions need to be taken immediately in order to preserve cash and survive through this period of social distancing? In response to this question, operators are currently working toward adapting their business models to meet the near-term challenges by implementing changes such as shifting to a delivery and carry-out model, reducing and streamlining menu options to maximize efficiency, and developing creative staffing solutions to help manage labor costs. The second question is one that will likely not be fully answered for several months, but that could prove to be more important than the first: what will be the long-term consequences of COVID-19 on the restaurant industry? While

[7] *Source: Department of Labor*
[8] *Source: Los Angeles Times*
[9] *Source: Restaurant Technology Guys*

time will tell what the full impact to the industry will be, the consumer is now more likely than ever to support the rise of ghost kitchens and virtual restaurants.

Just a few years ago, the notion of a restaurant kitchen with no physical store front was a revolutionary concept. Now, at the beginning of Q2 2020, the consumer is being forced to accept a restaurant experience outside of the dining room. The ghost kitchen concept was originally centered in the idea of a cost effective and streamlined method for restaurants to support the rapidly growing delivery business as consumers become more receptive to technology enabled delivery and take out solutions. One distinct advantage a ghost kitchen offers operators is restaurants with existing store fronts could segregate takeout and delivery services from inhouse dining. Restaurants can focus on the dining experience by limiting disruptions for dine-in guests while streamlining the delivery food preparations and delivery driver food exchanges. Prior to the pandemic, large fast-food chains such as Chick-fil-A, The Wendy's Co., Sweetgreen and Halal Guys were already utilizing ghost kitchens to expand their delivery options. Another advantage is that ghost kitchens offers entrepreneurs an opportunity to introduce new restaurant concepts in a more cost-efficient manner, allowing operators to scale their businesses without bearing the risks of significant overhead and operational costs that traditional brick-and-mortar restaurants typically incur. While many leaders in the restaurant industry acknowledged the potential benefits of the ghost kitchen concept, there were still concerns as to how quickly the consumer would adapt to the virtual restaurant experience and whether or not the demand for delivery would justify an off-site delivery center.

The COVID-19 pandemic in many ways has validated and reinforced the utility of ghost kitchens and paved the way for the expansion of virtual restaurants. Digital ordering and delivery have grown 300% faster than dine-in traffic since 2014 and the restaurant industry can expect this growth to continue as delivery businesses and restaurants seek solutions to counter the effects of COVID-19.[10] Moreover, over 60% of U.S. consumers reported ordering delivery or takeout once a week even before the 2020 pandemic started.[1] As off-premise dining trends continue to gain traction, ghost kitchens by their very nature are optimally positioned to provide restaurants with more localized kitchen spaces and better delivery to consumers. Research shows the share of consumers dining at sit-down restaurants has declined 85.2% since the COVID-19 outbreak which marks one of the largest behavioral shifts in the restaurant industry.[11] As the consumer is no longer afforded the option of dining in restaurants for the time being, the transition to off-premise dining will support the need for the ghost kitchen business model. Furthermore, the coronavirus crisis has placed a greater emphasis on cleanliness and sanitation on all consumer-facing industries. Opportunities arise for restaurant operators who embrace the ghost kitchen concept because they can leverage the virtual off-premise business model to reduce the congestion typical of delivery focused businesses. Not only will this help regain the confidence of the health-conscious consumer, but it will also enable restaurant operators to focus on the dine-in experience while meeting the new demand for takeout and delivery. Subsequently, sales volume will increase leading to greater overall profits in the long run. Restaurant operators concerned with the viability of offering a full scale off-premise service can also negotiate terms with third-party delivery operators to guarantee the volume and reach needed to be lucrative. Once their delivery process is in place, restaurant operators can employ a premium pricing strategy, which coupled with the operational efficiencies of using a ghost kitchen, ensures incremental sales remain consistently profitable.

Past research has evidenced takeout and delivery dining sales volume is at an all-time high and the limited dining options during the COVID-19 pandemic have accelerated this trend. According to Statista, the number of consumers using food delivery services has increased to 101.2 million, or a 6% year-over-year increase, in the U.S. As shelter-at-home mandates continue to persist, the number of consumers using food delivery services will presumably continue to climb. Ghost kitchens can aid restaurants by creating avenues solely dedicated to the demand-focused delivery market. Chick-fil-A exemplifies this as the company has reported increases in orders at three of their ghost kitchens based out of Chicago, Hollywood and Redwood City, California as a result of the restrictions mandated during this pandemic.[12] These statistics further support the growth of the ghost kitchen dining experience as the consumer has grown to accept and expect a virtual restaurant experience outside of the dining room. An interesting trend that will most likely emerge due to COVID-19 mandated restrictions is an increase in consumers trying various restaurants for the first time. Previously, the consumer would have been less likely to order takeout or delivery from a restaurant they have not yet experienced. Consequently, this will increase the customer pool of consumers trying new restaurants and will make it easier for virtual kitchens to establish a prominent foothold in the restaurant market.

Although ghost kitchens were slowly growing in popularity in certain metropolitan geographies over the last few years, the impacts from the 2020 coronavirus will usher in enduring consumer behavior changes as delivery becomes a more permanent component of the restaurant landscape. Consumers are currently being trained and reprogrammed to

[10] *Source: Upserve*
[11] *Source: PYMNTS.com,*
[12] *Source: Food Business Network*

eating outside of the dining room. As dine-in options have halted entirely, consumers are more likely to try takeout and delivery options, which would lead to experiencing new restaurants as well. Ghost kitchens and virtual restaurants that capitalize on the labor and cost efficiencies will be able to order higher quality food items at affordable price points. As a result, this will force restaurants to welcome new trends to accommodate rapidly evolving consumer preferences, creating a more competitive landscape for the restaurant industry.

What does this mean for existing restaurant operators? It is likely many restaurants will be unable to continue operating after having been shut down for an extended period. However, for restaurants that prepare strategically and can adapt to these challenging times, existing operators can benefit from the lower operating costs, higher quality of food, and increased competition in the new marketplace. If consumer behavior regarding delivery preferences after the pandemic continues to be a dominant demand in the restaurant industry, the ghost kitchen business model may prove to be a sustainable alternative for restaurants seeking to improve their operations and delivery processes.

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