QUARTERLY CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

DATE: July, 2012

TO: Manufacturing Friends and Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 1st Quarter, Calendar Year 2012

First quarter numbers are the most positive in at least 5-6 years, most encouraging are the traffic patterns. With the caveat that winter 2012 was one of the mildest winters ever recorded – especially in the Midwest. Certainly that had a positive impact on traffic.

The leaders continue to perform well, having figured out how to be the brands of choice. McDonald's (+8.9%), Starbucks (+8%), Chipotle (+12.7%), Panera Bread (+7.5%), Dunkin Donuts (+7.2%), Pollo Tropical(+9.4%) and Popeye's (+8.1%), among others did well. Consumers are still searching for value and innovation, often times in the same occasions. Most of these brands have continued to innovate not only on the menu but in service offerings as well.

Overall, casual dining is a mixed bag. The traffic trends have been encouraging (some have said due in part to the mild winter, and a modest reduction in gas prices), yet some of that short-term optimism has eroded. Red Lobster (-3.9%), and Olive Garden (-1.8%) are the most obvious examples. The most noticeable number is the decline in Red Lobster traffic (-8.1%) — that's a concern. Some casual dining brands did quite well this quarter, such as Buffalo Wild Wings (+9.2%) and Texas Roadhouse (+6%)

The brands generating positive numbers have become more effective at getting closer to their consumers and getting more consumers through the dining experience. As an example, BJ's (+3.3%, lapping 7.8%) recently transitioned a number of their 4-top tables to 2-tops, resulting in a $20K per seat increase in sales from each additional seat. This, while they work on developing individual loyal consumer profiles! One result has been the growth of 2 menu items per guest from 1.75 in 2010. Those numbers add up.

Another consideration — many of the casual dining brands showing positive sales are newer, so they have more room for growth. This may suggest that the younger consumers find the newer brands more relevant, as their life phase is more conducive to dining out more frequently than baby boomers, who's away from home eating occasions decline over time.

The question for BJ's is more long term – how long can they continue the stellar performance as they grow. The biggest challenge will be finding, training and developing restaurant managers. Today, they will not hire anyone into a general manager position from another concept, so part of their growth potential is how full they keep the pipeline of talented general manager candidates. Regardless, they are on a lot of radar screens today and have done extremely well in a difficult economic environment, in challenging geography (about half of their stores are in California).

Sadly, some casual dining brands are being left behind, having lost relevance. Ruby Tuesday's is an example. Despite a number of initiatives over the past 3-5 years, they have so far not been able to stop the sales declines. Recently, Founder Sandy Beall, announced his plans to retire from management and the board. An industry icon, he built a legacy brand primarily on his own instincts and insights. One wonders what might have been had they become more consistent users of empirical, fact-based consumer insights sooner to drive strategy and menu decisions.

On the subject of empirical data, we are still shocked by how many manufacturers will ***rely only on instincts, experience and their own views*** of the marketplace to drive strategy. This is extremely risky in this environment. You need to be listening to and talking to your own customer base, and using unbiased third-party data and analysis to understand the subtle complexities in the market place, and how it will impact your customers, prospects and new opportunities within existing customers.

The reality for the manufacturers is still to be very selective about investing much in a custom development project with the struggling brands. You run two risks, the first being a change in senior management – especially in the Presidents or CMO role. Historically, when there's a change, if business has struggled, there is a new direction. In that case, your 6-18 months of work, relationship building, etc. vanish in about 2 weeks! The second concern is volume – if traffic is declining and sales are flat or up only because of price increases, then menu velocity remains unchanged or may even decline.

Finally, keep an eye on Wendy's. New President & CEO Emil Brolick returned to run the company last September and has already begun to have an impact. He's the type of leader who is very effective at leading change. A couple of examples: The remodel program is generating a 20% sales lift and there's a new focus on generating more drive thru business, an under-developed segment at Wendy's. They are working on a more robust new product pipeline, and will take learning from both Taco Bell (where Brolick served as President) and Subway as they work their way back into breakfast.

We removed both Morton's and McCormick & Schmick's this quarter as both were recently acquired by Landry's, which as a private concern, does not report quarterly earnings.
Two new companies (four new brands) appear on our update this quarter. The Fiesta Restaurant Group which is comprised of San Antonio, Texas-based Taco Cabana and Miami-based Pollo Tropical. Also new to the update is the Columbus, Ohio-based Brio/Bravo Restaurant Group, the parent of Brio Tuscan Grille and Bravo! Cucina Italiana. Each of these four brands is worth a try!

We believe each of these brands has significant upside growth potential — both in same store sales and new unit growth. Additionally, these brands could represent growth for a select group of manufacturers.

The 1st Quarter 2012 Same Store Sales Reports

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited/Quick Service				
Burger King	+4.2%			
Carl's Jr.	+1.7%			
Chipotle	+12.7%			
Domino's	+2.0%			
Dunkin Donuts	+7.2%			
Hardee's (CKE)	+6.1%			
Jack in the Box	+4.2%			Qdoba +3.0%
McDonald's	+8.9%			
Panera	+7.5%			
Papa John's	+1.8%			
Popeye’s	+8.1%			Lapping a +3.9% SSS from the previous year
Pollo Tropical	+9.4%			
Sonic	+2.8%			
Starbucks	+8%			
Taco Cabana	+6.2%			
Wendy's	+0.8%			
Yum! Brands (US)	+5%			
KFC	+2%			
Pizza Hut	+5%			
Taco Bell	+6%			
Full Service – Family, Casual and Upscale				
Applebee's	+1.2%			Slight traffic decline, offset by higher average check
BJ’s	+3.3%			Lapping a +7.8% increase
Bob Evans	-0.6%			

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Buffalo Wild Wings	+9.2%			+9.2% Company stores, +7.3% Franchised stores
Carrabba's	+4.3%			
Cheesecake Factory	+2.6%			
Chili's	+4.6%			
Cracker Barrel	+3.1%			
Denny's	+2.4%			
Famous Dave's	-1.6%		+3.1%	
IHOP	-0.5%			Traffic decline, higher average check minimized decline
Longhorn	+3%	+2%	+2.8%	Mix shift of -1.8%
Olive Garden	-1.8%	-3.9%	+2.8%	Significant traffic decline in May, minor mix shift
Outback	+5.1%			
PF Chang's	-0.6%			Being acquired by PE Firm, Centerbridge Partners
Red Lobster	-3.9%	-8.1%	+2.8%	
Red Robin	+0.5%	-3.6%	+4.1%	Declines in traffic, yet able to take pricing
Ruby Tuesday's	-5.0%			Planning to close at least 25 units this year
Ruth's Chris	+3.7%			
Steak 'n Shake	+4.8%	+5.2%		Again value offerings driving increased traffic and sales
Texas Roadhouse	+6.0%			

<u>Implications for Foodservice Manufacturers</u>

This is clearly the brightest outlook we have had in several years for the chain restaurant world. However, the overall environment has not really changed much. Part of the performance is chains lapping lower growth numbers from last year. Part of the change is also that most chains have closed their non-performing units, and gotten through the pain of downsizing.

We are seeing many of our restaurant clients more interested in real estate site selection and market development strategies. This is a good indicator that chains will start building units and expanding geographically once again – but this will probably not have a significant impact on sales for another year or so.

We feel a bit like a broken record (MP3?) these days, but the reality is, there are winners, losers and a large group in the middle. If you see an opportunity to take volume from a competitor at a livable margin from a chain that is meandering in the middle – go for it. If you are reassessing the marketplace and determining where to invest time, money and resources, take a hard look at the same store sales growth, the drivers behind that growth (pricing? Not so good. Traffic? Very good.) and place your bets accordingly.

As always, please feel free to contact us with any comments or thoughts, especially if you think we missed something, or you disagree with our conclusions!

Regards

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