



QUARTERLY CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

DATE: December 19, 2014

TO: Manufacturing Friends and Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 3rd Quarter, Calendar Year 2014

The 3rd Quarter 2014 Same Store Sales Reports

Two brands have dominated discussions around the 3rd Quarter - McDonald's sales declines, and Chipotle's incredible performance. The fact is 3rd Quarter 2014 was actually pretty good for most chain restaurants. Let's do a fist bump for the lower gas prices and hope they last for a while.

Gas prices have dropped significantly. Nationally, the price for a gallon of regular peaked at \$3.66 in mid-April, today the national average is \$2.48 per gallon, down from the all-time high of \$4 in April 2011. That can be great news for the chain restaurant business. Most importantly the decline impacts the consumer attitude and mindset more than anything else.

We've talked about how the strength and consistency of Chipotle's culture drives their performance. They continue to perform well with an unheard of SSS performance of +19.8%. We also believe McDonald's culture will be the primary factor influencing how they respond to their current challenges, as it is with any organization facing difficult times. Culture will trump new initiatives every time.

McDonald's has an assortment of issues causing their recent sales challenges. The value menu is so strong that consumers traded down and many stayed there. The food is acceptable, especially for the price.

A significant factor in their success over the past ten years *has been* the new menu offerings, which also increased operational complexity - it's tough to do all those things well. Perhaps they finally hit the tipping point. This, as hamburger fast casual has grown, with relatively simple menus and very competitive price points (Five Guys in Dallas - \$6.29 for a burger). Today, \$4.80 is the average domestic price point for a Big Mac, up from \$3 ten years ago.

Even with all the new menu offerings, the top five selling items are still 30% of sales (Big Macs, hamburgers, cheeseburgers, McNuggets and fries), and there's no shortage of competition for those products. Hence the pressure to customize burgers. "Create Your Taste," is now officially a McDonald's initiative.

The chicken business has been an extremely competitive segment. Popeye's (+7.2%) simply has a more compelling offering, and more of their stores are in newer trade areas than KFC (flat). Oh yes, and then there's Chik Fil A, which continues to perform well in every new market they enter. That's not to mention PDQ, an interesting and innovative chicken chain coming out of the Southeast.

Domino's (+7.7%) has made an incredible come back. A few years ago, they openly admitted that their product was not very good, and that improvements were underway. Since then they have significantly improved their product, focused on that, and delivered value. Pizza was strong this quarter for some others (Papa John's +7.4%) and not so much for others (Pizza Hut -2%).

Some organizations have made it a practice to explore other concepts and formats. There are two strategies - invest in some emerging brands as Buffalo Wild Wings has done, or start from scratch like Yum. (*Yum Brands has opened Bahn Mi in Dallas, a fast casual Vietnamese concept*)

Both Yum and Buffalo Wild Wings (invested in Pizza Rev and Rusty Taco) are taking the initiative to learn more about how consumers' tastes and preferences are evolving. These efforts give the parent organizations unique real world insights on the specific brands, but also some additional perspective about which groups of consumers are more likely to embrace new concepts and formats.

The established movement towards better ingredients, fewer preservatives (ingredients consumers can actually "pronounce" - according to Yum's Greg Creed), and healthier food is now the expectation. Most of the manufacturers we have talked to are well down that path. If you are in that group, stay with it - that's where consumers have been and will continue to head. Those consumers include baby boomers, who are beginning to pay attention to that information and are still the largest consumer group in the economy.

The nationally mandated menu labeling, due to happen next year, will add even more energy to that interest. You can expect an onslaught of media attention. We'll see how much it changes behavior.

The Italian Casual Dining players (Brio/Bravo -5.2%/-6.7%) continue to suffer sales/traffic declines. Macaroni Grill's traffic was off 13% - that's a serious problem. There a number of theories and perspectives on the causes. One consideration has to be the emergence of not only fast casual, but other brands that compete with Italian for Casual Dining occasions - Mexican and others.

Two updates for this quarter - Einstein's is removed from the update as their purchase by Luxembourg based JAB Holdings means they'll no longer report quarterly results (JAB has

controlling interest in Peet's Coffee and Caribou Coffee in addition to some other investments). We add Southern California based El Pollo Loco, which recently did an IPO.

3rd Quarter 2014 SSS Sales by Brand

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited/Quick Service				
Burger King	+3.6%			Includes Canada
Chipotle	+19.8%			Plan to open at least 190 new restaurants in 2015
Domino's	+7.7%			Value and improved product, lapping a +5.4%
Dunkin Donuts	+2.0%			120 new stores opened this quarter
El Pollo Loco	+7.9%			
Jack in the Box	+3.1%			
McDonald's	-3.3%			
Panera	+1.4%			
Papa John's	+7.4%			
Popeye's	+7.2%			Lapping a +5.1% last year
Pollo Tropical	+5.9%	+4.6%		
Pot Belly	+0.5%			
Qdoba	+7.7%			
Sonic	+4.6%			Lapping +5.9% last year
Starbucks	+5%	+1%	+4%	
Taco Cabana	+3.5%	+0.9%		
Wendy's	+2%			
KFC	Flat			
Pizza Hut	-2%			
Taco Bell	+3%			Increase driven by breakfast
Full Service				
Applebee's	+1.7%			
BJ's	+0.3%	+0.7%		
Bob Evans	+2.7%			
Bonefish Grill	+2.6%			
Bravo Restaurants	-6.7%			
Brio Restaurants	-5.2%			
Buffalo Wild Wings	+6.0%*			*463 Company stores,(+5.7% at 588 franchise stores)
Carraba's	-1.2%			
Cheesecake Factory	+2.1%			-2.0% @ Grand Lux
Chili's	+2.3%	+0.1%	+1.8%	Majority of increase was price increases & mix shift
Chuy's	+3.0%	+1.3%	+1.7%	
Cracker Barrel	+3.3%	+0.8%	+2.1%	
Denny's	+2.4%			

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Famous Dave's	-5.7%			Declining traffic & sales challenges continue
Fleming's	+4.8%			
IHOP	+2.4%			
Joes' Crab Shack	-4.4%	-6%	+1%	
Longhorn	+2.6%	-1.2%	+2.1%	
Macaroni Grill	-8.5%	-13%	+5.4%	15 Restaurants Closed
Olive Garden	+0.5%	-3.1%	+1.9%	
Outback	+4.8%			
Red Robin	+0.9%	-2.3%	+3.2%	(402 company stores, 98 franchised stores)
Ruby Tuesday	+1.1%	+1.3%		*668 Company stores (+6.0% at 31 franchised stores)
Ruth's Chris	+4.8%	+3.3%	+1.4%	Mitchell's brand sold
Steak 'n Shake	+1.0%	+0.5%		
Texas Roadhouse	+5.9%	+4.4%		*360 Company stores, (+5.2% @ 75 franchised stores)
Yard House	+3.7%			

Implications for Manufacturers

For manufacturers the chain business challenges continue to frustrate and challenge even the best thinkers and strategists. Like you didn't have enough to worry about with the Sysco/US Foods merger!

Recently, we've had a number of discussions around the best practices in sales process, skills and overall effectiveness. In a mature business, skills and process matter **much more** than when the business is growing overall. As a result, more than a few manufacturers are struggling with how to get better results from their sales efforts and investments. The answer is better execution, which means using the right **system** combined with better **capabilities**.

Two elements comprise sales force and individual sales person effectiveness - which is required to drive revenue and profits. Those elements are **systems** and **capabilities**, which are often confused. One is not a substitute for the other - you need to have both.

Sales **systems** (Miller-Heiman, Salesforce.com and many others) are valuable to be sure, and we endorse the use of some system (whichever one works for your team is fine - the key is that everyone must use it consistently!). Here's where some get confused. A sales system is not the same as sales capabilities. Effective use of Miller-Heiman or some other system **will not**, in and of itself, help you improve sales performance nor help you gain new clients.

We've had dialogue with at least 5 of our manufacturing clients who have recently invested in Miller-Heiman, a sales system. The overall results can be characterized by one client who said: *"It didn't get us one additional box of business. It was as though we had purchased all these*

blueprints and equipment to build a house, but no one actually knew how to build a house - no one knew how to hammer a nail in correctly”.

Sales **capabilities** are comprised of the actual sales skills and capabilities your team has (or lacks). These specific capabilities are critical to gaining new business and growing your existing customers business. These capabilities include connecting with new buying influences, conducting effective needs assessment discussions, setting priorities, managing complexity and managing conflict (internal and external - both matter). Reorganizing is great, but that is not going to improve your capabilities!

There are a few good skill set programs, such as the Sandler system. To those of you who know us well, you won't be surprised to learn that our preferred sales competency skill program is the one detailed in our own Mac Brand's book, "**Silent Selling**", published in 2010. We're happy to talk further about that one any time. We know it works.

Whatever your business, you need to keep working on new customers and new opportunities - that doesn't ever change. To be successful, you need an effective system combined with strong capabilities. Finally, please don't confuse a reorganization as a substitute for either! They can be part of the process, but reorganizing the same group of people without also working on their capabilities isn't going to improve your business.

As always, we look forward to your thoughts and feedback.

Regards,

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