UPDATE

BELLWETHER FOOD GROUP, Inc.

DATE: November 20, 2009

TO: Manufacturing Friends and Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 3rd Quarter, Calendar Year 2009

The 3rd Quarter 2009 SSS reports provide confirmation of an industry undergoing a fundamental shift in the way many consumers will use restaurants over the next 2 – 3 years, especially full-service brands. There will be fewer occasions to dine out, and consumers will continue to be more value/cost conscious. Certainly, that comes as no surprise to anyone who has been paying attention.

There are very few exceptions, and so far those are the newer brands, such as Panera and Buffalo Wild Wings. They not only execute well, but also are more relevant to the younger consumers, whose lifestyle patterns are more conducive to using restaurants/sports bars. Another place for opportunity is in family dining — with the value play. The best evidence of that is the success that Steak N Shake is having. They use a value strategy, which has been successful so far, as evidenced by their excellent SSS patterns — up 8% overall in the past two quarters.

Interestingly, that brand is not run by a career restaurant professional, but by someone from the financial community. One person described his approach in an interesting way, "*He's not hung up on what used to work in the restaurant business, he sees the market with a fresh set of eyes, and has a very good sense of what really matters to their customers*".

The landscape is changing for at least the next three years — Bellwether Food Group does not see any evidence to support industry growth back to pre-downturn levels until at least 2012. One major reason is the reality of under employment.

Under Employment

This is an important factor. The unemployment figures are just over 10%, which is not good news. Yet that does not tell the whole story, especially as it relates to consumer spending in commercial restaurants. The "under employment" factor, meaning the impact of those making significantly less income than 1 – 2 years ago is one of the unreported factors continuing to hurt foodservice. From what we have seen, our estimate is that the real impact of lost/lower incomes is closer to a net effect of 18 – 19% unemployment.

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The bigger concern is how many of these lifestyle changes are driven by structural changes in many industries, and therefore, are not short term. Industries such as electronic media, banking, retailing, manufacturing and others have eliminated many middle management positions, those paying between the ranges of $60,000 – $125,000 annually. Many of those affected have found other work, but at significantly lower pay. In some businesses, those jobs will not come back for some time. There is, and will continue to be, a smaller amount of discretionary income available for restaurant spending, impacting all in the supply chain, from valet parkers to cleaning crews.

This new reality really affects consumer sentiment and confidence, and ultimately overall, expectations. Consumers figure out, and then accept that they can get by just as well with eating out less often, skipping the 2nd or 3rd alcoholic beverage with dinner or forgoing dessert/appetizers. None of those conclusions are good for either manufacturers or restaurant operators.

So, with that enthusiastic introduction, let's look at the numbers.

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited/Quick Service				
Arby's	-9.0%	NA	NA	Announced plans for dual brand locations test, 3 stores planned for 2010, targeting high cost real estate markets
Burger King	-2.5%	NA	NA	
Carl's Jr. (CKE)	-5.2%	NA	NA	
Chipotle	+2.7%	NA	NA	
Domino's	0%	NA	NA	
El Pollo Loco	-10.1%	NA	NA	
Hardee's (CKE)	-1.8%	NA	NA	
Jack in the Box	-4.0%	NA	NA	
McDonald's	+2.5%	NA	NA	
Panera (company stores)	+3.3%	+1.8%	+1.5%	
Papa John's	Flat	NA	NA	
Popeye's	+.3%	NA	NA	
Sonic	-4.5%	NA	NA	
Starbucks	-1%	NA	NA	
Wendy's	-0.1%	NA	NA	
Yum Brands	-6%	NA	NA	Pizza Hut the most challenged, NPC reporting SSS of -10%
Full Service				
Applebee's	-6.5%	NA	NA	
Bob Evans	-2.8%	-5.1%	+2.3%	Mimi's off -6.8%, menu prices +2.2%
Buffalo Wild Wings	+0.8%,	NA	NA	Company and franchise sales respectively

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
	+1.9%			
California Pizza Kitchen	-8%	NA	NA	
Cheesecake Factory	-2.8%	NA	NA	Small plates & snacks menu expanded
Chili's	-6%	NA	+1.9%	
Cracker Barrel	-1.4%	-3.8%	+2.1%	
Denny's	-6.6%, -7.3%	-7.3%	+0.8%	Company stores, franchise stores respectively
Famous Dave's	-6.8%	NA	NA	
IHOP	-1.1%	NA	NA	
Longhorn	-6.2%	NA	+2%-3%	Monthly traffic declines between 6%-10%
McCormick & Schmick's	-18.8%	-14.2%	+4.6%	
Morton's	-16.8%	NA	NA	
Olive Garden	-2.9%	NA	+3%	Monthly traffic declines between 3%-6%
Outback	-11.1%	NA	NA	
Perkins	-8.3%	NA	NA	
PF Chang's	-8.5%	-6%-7%	NA	Slight decline in average check, customer managing the check
Red Lobster	-7.9%	NA	+1%-3%	Monthly traffic declines between 7%-13%
Red Robin	-9.8%	NA	NA	
Ruby Tuesday's	-3.1%, -6.5%	NA	NA	SSS Company stores, franchise stores respectively Sunday brunch program expanding past initial 50 units
Ruth's Chris	-24%	NA	-3.3%	-21.5% average entrée price reduction
Steak N Shake	+8.5%	NA	NA	
Texas Roadhouse	-4.6%	NA	NA	

The same store sales numbers give a good indication, but tell only part of the story. As a supplier, it is critical to look at the traffic and price increase/decrease numbers to get the whole story, as well as looking at the trends over the past 18 – 24 months.

Some brands will simply not do as much volume, and will have to adjust. Famous Dave's is a case in point, given the 6.8% decline for this quarter, which laps a 4.7% decline for the same period last year, meaning an 11.5% decline from two years ago. Given some price increases along the way, this indicates that the real health of the business, traffic, is off some 15% over the past two years. Given the consistency of those patterns, it is pretty clear this is a fundamental structural shift.

Another example is the Chili's brand. The most recent sales are down 6%, with a price increase of 1.9%, which means the net decline in traffic is basically 8%. Yet, during the same period last year, the net was a negative 3% in sales, with a 3.3% pricing increase, which means traffic was down 6%. The quick math — the traffic for the two year period, is down around 14%, the same issue the vast majority of these brands face which is the fundamental shrinking of the category. There is shrinkage and pain all around.

For operators overall, one fundamental challenge is balancing the need to sustain traffic against margin/price points, while maintaining what is left of the integrity of their pricing structure. One way many operators are attempting to retain margin, is to be very selective about discounting beverage prices, especially in full service.

Implications for Manufacturers

Placing the right bets, having fewer, better sales people

In one recent client project, we got what we thought was some unusual, yet very interesting feedback around the level of professionalism, as evidenced by the sales professionals who call on them. One comment sums it up quite well — "*There is a new class of really excellent sales people emerging. You can identify a few that truly understand my business; they know how our restaurants and organization really work. You can tell they have really thought through whatever recommendations they make. They help me grow the business. I see a much higher level of individual professionalism; they have earned the inside track here."*

Since early September, we have interviewed some 50 chain restaurant executives, ranging from marketing, to menu development to purchasing, on the subjects of how they make menu decisions and what the best suppliers do for them and how those suppliers differentiate themselves. We heard a particular theme from six of those we interviewed, which we thought was worth sharing. The professionalism and overall business literacy of the sales professional was noted. To be sure, not a solid trend yet, but nonetheless noteworthy.

For manufacturers, this means a higher caliber of sales person. A sales person who as is comfortable passing on a poorly qualified opportunity as they are developing/sustaining quality relationships at the Vice President and the C level, is an emerging competitive advantage.

Last quarter we reported surprisingly, that a few operators were more receptive to off the shelf products than in the past for a number of reasons. We see these trends continuing. There are three primary issues driving this pattern, the time and energy in dealing with the distributors (sound familiar?) and the money, followed by speed to market for a new item. If a chain has a limited time offer they want to introduce right away, no one wants to lose 30 – 45 days debating a Sysco sales manager about additional skus or inventory while the competition takes traffic.

The Targeting & Prioritization Protocol

One of the ways smart manufacturers work through where, and determine how much to invest in today's climate, is to set priorities as an organization, by utilizing these six elements of definition and analysis:

- **Strategic Fit:** Are the strategies, targets and goals of the chain aligned with your strategies and goals?

- **Size of the Prize:** How big is the opportunity on a quantitative or relative measure? Does it justify the investment?

- **Accessibility:** How accessible is the account? Do you have relationships in the right places today? Do you have the marketing relationships and a thorough understanding of their strategy and the importance of your category? Do you know how the chain makes decisions?

- **Transactional / Relational:** How does the account typically behave when selecting products in your categories? Is the account primarily focused on cost — hence transactional? Or, are they more interested in a long-term relationship, and can they see the benefits of working with a "co-investor" in their business?

- **Innovation Score:** How important is innovation to the chain? Are they known for entering new categories and driving culinary innovation, or not?

- **Financial Health:** this assessment, with clear guidelines and protocol is one that must be a part of this process. Consider these questions: Is the chain growing? Are they able to take price increases? Do they have cash (public companies)? Are the franchisees in trouble? Are they able to get financing to expand? Are they in bankruptcy?

If you have any additional questions, comments or some additional insights, please feel free to call any of us.

Regards

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