MEMORANDUM

BELLWETHER FOOD GROUP, Inc.

DATE: November 3, 2008

TO: Manufacturing Friends & Colleagues

FROM: Mac Brand

RE: Restaurant Same Store Sales (SSS) Third Quarter, Calendar Year 2008

The 3rd quarter of 2008 showed consumers trading down — managing check or simply staying home. The casual dining chain operators we have spoken with are most concerned that overall traffic is not only slowing, but has turned negative. In private conversations, many are worried that as the economic malaise continues, consumers' habits will fundamentally change, permanently. According to one President/CEO, "*it's one thing if the consumer has a bad quarter, what I'm worried about is that over time, these families will get used to not going out to eat dinner as regularly, that's a big concern for us."* Most believe that tough times are here for at least another 18 – 24 months.

In planning for that, many casual dining operators are working a value menu strategy, and/or strategies to sustain or improve off-premise business, while working to get consumers to purchase an alcoholic beverage while they wait for their off-premise orders. One substantial challenge: Many brands have dedicated off-premise strategies. This means that parts of the operation — dedicated off-premise facilities, parking lot arrangements — are specifically set up for off-premise business. They are not necessarily set up to facilitate on-premise beverage occasions. This can require some creative thinking to facilitate. If sales continue to decline, then attracting and retaining quality wait staff and bartenders becomes a challenge.

For innovative QSR operators, these times represent an opportunity to sustain their fundamental consumer value: quality, service, convenience and value. The successful QSR brands are doing it with new product news and new beverage offerings.

Ahead of the game Same Store Sales (SSS)

Conventional wisdom contends — consumers trade down during economic uncertainty and difficulty and many of the QSR sales trends reflect that. The QSR brands recognize this represents an opportunity to enhance loyalty among core user groups.

Quick Service/Fast Casual

- McDonald's — U.S 3rd quarter SSS rose 4.5% driven by the popular breakfast menu, the Olympic-themed Southern Style Chicken Sandwich and Biscuit promotion and everyday affordability with a special focus on beverages. The continuation of four key growth strategies — chicken, breakfasts, beverages (excellent margins) and convenience (improved through-put) drove results.

There continues to be pushback from some in the franchisee community around the new espresso-based coffee program and the related costs. Franchisees always push back on capital expenditures, yet McDonald's has proven over time they are patient with new initiatives. If this is successful, it will simply, more firmly establish McDonald's as the category leader, and many of their competitors will have to figure out a way to compete in that segment.

- Chipotle — 3rd Quarter SSS up 3.1%. Steve Ells, Chipotle Founder, Chairman and CEO had this to say about the quarter, "*Ingredients from more sustainable sources will strengthen our relationship with customers and help us continue to earn their business, especially in these challenging times. During the quarter, we continued to make progress in our efforts to serve Food with Integrity, by significantly increasing the amount of produce from local farms served in our restaurants when in season.*" The senior management team not only "walks the talk", they spend significant resources on indoctrinating the store crews and managers on the business practices that support this philosophy.

- Burger King — Fiscal 4th quarter sales up 5.5% in the most recent quarter. The new product news is the primary driver — the combination of being open longer hours in many markets and expansion of the breakfast menu. In addition, movie tie-in related products, such as the Indy Whopper™, as part of The Kingdom of the Crystal Skull movie.

- Panera — Company-owned 3rd Quarter SSS up 3.0%, franchisee SSS up 3.5%, as they finally suffered a real decline in traffic of 3.2%. Yet, the recent price increases have held, as they continue to work on the fundamentals, such as speed-of-service.

- Carl's Jr. — 3rd Quarter SSS up 1.6% which is driven by new product news. They are more concerned with the long-term health of their brands, rather than discounting the Guacamole Bacon Burger, Jalapeno Chicken Sandwich, and the Monster Breakfast Sandwich™. Carl's Jr. realizes the brand image is negatively impacted by short-term discounting tactics.

- Hardee's — 3rd Quarter SSS up 3.3%, driven by new products, such as the Red Burrito Taco Salad™ and the Strawberry biscuits, which continue to drive incremental breakfast traffic

- Yum Brands — The U.S. 3rd quarter SSS up 3%, led by growth of 4% at Taco Bell and Pizza Hut. New product news, especially the pasta offerings at Pizza Hut, are an apparent factor in the positive results. KFC issues continue with a 4% decline. The non-fried chicken sandwich is not moving the needle, at least initially.

Full Service

- Olive Garden — SSS increased 2.4%. Its 56th consecutive quarter of same-restaurant sales growth, based in part on managing price on select menu items, and subtle enhancements to their wine program and staying true to their brand promise.

- IHOP — SSS increased 0.2% for their third quarter, 2008. Once again, it is new product news — Tour de French Toast and All You Can Eat Trick or Treat Pancakes driving the flat real performance.

- Famous Dave's — Company stores 3rd Quarter SSS increased 1.7%, including a 1.6% price increase instituted on June 2nd. The USA BBQ Tour — LTO was a factor in the increase, however franchisees SSS declined 1.4% in the same period. This occurred despite some pockets of strength in the franchisee community, suggesting market specific issues.

- Bob Evans — 3rd Quarter SSS up 2%. Menu prices up 2.9%, a sign of improving but not great health. Once again, new product news — Big Farm Salads, combined with two new Knife and Fork sandwiches.

Behind the game (SSS)

Pain all the way around for full-service chains, especially casual dining which continue to suffer the most in the current environment, prompting one President to suggest that "*Flat sales is the new up!*"

Quick Service/Fast Casual

- Jack in the Box — 3rd quarter company SSS decreased 0.4% in the third quarter compared with a year-ago increase of 7.4%. While we give them credit for the "Real Fruit Smoothies", we're not convinced that is enough new product news to compete. The fact is, overwhelmingly, smoothies are either a meal replacement or beverage-only occasion.

- Starbucks — last quarter SSS reported as "mid-single digit decline". This is clearly a brand in transition, as the realization hits that consumers have reacted negatively to recent price increases. Interestingly, the smoothie style products are not faring well (low repeat sales)

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and surprisingly, the oatmeal offering for $2.45 is averaging between 10 – 17 orders per store per day.

- Sonic — SSS declined 0.4%. The transition from regional to national player is beginning to take its toll on the organization. The continuing challenge for Sonic's growth will be the viability of not only the seasonality issues inherent with the car delivery model, as well as the financial realities of the concept footprint in more expensive real estate markets, such as the Northeast and California. Of course, further away from the significant population centers in California, such as the Inland Empire, and the 1 – 5 agricultural corridors, the real estate model fits better. Yet they would face the challenge of strongly entrenched In N' Out Burger, Carl's, Jr, and Jack in the Box, in addition to the strong national players. If you are a Sonic supplier, or working to become one, you need to be aware of these realities.

- Wendy's/Arby's — the merger is completed and no financial reports will be provided for the balance of 2008. Yet, the new CEO has made it clear the Wendy's breakfast launch needs a redo.

Full Service

- Ruby Tuesday's — suffered a 10.8% decline in 3rd Quarter SSS, following a 9.8 % decline in the second quarter and 12.7% decline in the first quarter. Structurally, they face the challenge of having about 1/3 of their stores in or near shopping malls — as consumers reduce visits for shopping, the brand suffers. Too risky to state!

- Brinker — Chili's 3rd quarter SSS declined 3%. On the Border declined 3.3%; the Macaroni Grill sale is completed, and is expected to close by the end of the year. As was the case with many in full service, the last 2 – 3 weeks of September were particularly challenging.

- Applebee's — SSS decreased 3.1% for the third quarter 2008, on top of a 4% price increase, which means overall traffic was down 7%! DineEquity has been selling the company-owned Applebee's stores to finance the purchase of the company, so the current lending crisis creates immediate problems for potential buyers and DineEquity management.

- Red Lobster — 3rd Quarter SSS decreased 3.7%. The issue is traffic, despite the strong product promotions.

- Cheesecake Factor — 3rd Quarter SSS down 4.8%, as the company lowered 2009 unit growth plans to 3 – 5 units from initial plans for 7 – 9 units. This is as much a sign of senior management pragmatism, as it is the real estate and consumer environment.

- Ruth's Chris — 3rd Quarter SSS for Ruth's decreased 7.1%, compared to a 0.4% decrease in 2007, prompting another key management change.

- The Capital Grille — 3rd Quarter SSS decrease of 8.6%, primarily a decrease in overall traffic.

- Cracker Barrel — SSS were down 1.2%. This includes the effects of a 3.8% higher average check, driven primarily from an average menu price increase of approximately 3.7%, meaning they are losing traffic. Tough times exacerbated by a decline in vacation travelers during the peak vacation season.

- California Pizza Kitchen — 3rd Quarter SSS decreased 2.4% compared to 3.5% increase in the third quarter a year ago.

The Questions

We are hearing these fundamental questions from both the manufacturers and chains:

- Manufacturers — "How do we look at more effective ways to deploy the sale forces?", and "which operator segments will offer the best opportunity for profitable growth?"

- Operators — "How can we identify the most important consumer segments and need states to focus on?"

Implications for Manufacturers

The operator segment is going to shrink, no question. The issue, as always, is where to place your bets.

In planning for the next 12 – 24 months, we recommend accepting the reality first — the operators' business is not likely to grow in 2009, in fact many are planning for a 3 – 7% decline. New store construction will be at a minimum for most because of multiple issues, not the least of which is, the financing challenges. We recommend taking a look at your thinking, planning and execution for your national accounts and street businesses.

- **Setting Priorities Effectively** — It is critical to consistently use a well-defined, disciplined, and rigorous targeting and prioritization process, which includes the chain's financial health. You do not want to be in the middle of a development project, with some $100,000 invested with the next Bennigan's! A key element is to clearly understand the customers' business, and specifically, the chain restaurant brand, and their overall direction

- **Reassess the deployment of sales and product development resources** — the first place many manufacturers look is at revamping the geography driven model for national

accounts. In this changed environment, we have recommended structuring the national accounts team assignments based on the strengths of the sales person (breaking new ground, managing existing business, complex relationship management, administrative, negotiations, commodity knowledge, etc.). We recommend applying the appropriate resources to the accounts based on their needs and market position (a combination of their growth patterns, management style, overall needs, willingness to innovate, the importance of price/commodity costs, strategic importance of your product category to the restaurant brand)

- Realistically, today, it is the smaller, emerging chains, with lower volumes that are taking risks and innovating with the menu. The focus first, should be on understanding which chain operators are playing defense, which are growing/innovating, whether they are still growing and which run the greatest risk of not being worth the investment.

- **Work on programs that will boost traffic/sales in the short term**-Most chains are working only 6 – 18 months out. At the same time, the Limited Time Offers (LTOs) are a way to boost same store sales, which is important to almost everyone at the corporate office on any type of bonus program! Especially in the "C" Suite. One key for successful LTOs, is beverages, the margins are tough to beat!

- **The relationship with the marketing function at the chain companies is critical-** to those of you who know us, this message will sound familiar. Product development generally takes the direction from marketing — who is *their internal* customer. In many chains today, product development reports to marketing. If your national accounts teams don't know this or won't accept it as the real world today, then they are simply misguided/not up to the task, and need to be replaced. If they understand that these relationships are essential, and are struggling to establish those relationships, that is different. That is a skill development issue, which we or some other firm can help with.

This is not to suggest, that the working relationships with product development and purchasing don't play a role, they do. Yet, if you don't have a dialogue with marketing, and are not having strategic discussions with marketing, you are at a competitive disadvantage and are not positioned to win.

- **Finding the pockets of growth** — Some chains are growing and doing well. The challenge for most manufacturers is identifying these pockets of growth, and putting the right resources towards them. If one of your targets is struggling with declining sales patterns, you need to be selective about how much to invest in a brand that is losing sales. Closing stores is not always a negative. Starbucks is closing some 600 stores, and we believe that is a good thing.

You may be better positioned for success in generating new, profitable business, by refocusing on the right emerging and growth chains, versus a heavy investment in the legacy, limited growth brands. In addition, more than ever, the national accounts team needs to have the ability to have the C Level discussions. If they can't get the meetings, or insist they don't matter, then you need to take a serious look at your talent in those roles. We mean now, not next year!

The Targeting & Prioritization Protocol

One of the ways our clients work through where and 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?

For more insights on how to plan for more effective and profitable execution, feel free to give any one of us a call.

Regards

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