



3RD QUARTER 2016 CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

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TO: Manufacturing Friends & Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 3rd Quarter 2016

3rd Quarter 2016 Same Store Sales Reports

A respectable Q3 for most limited service brands, with a wide range of performance patterns being reported (Chipotle being the outlier, still suffering -20s SSS declines). In Limited Service, Del Taco (+6.7%), Dunkin Donuts (+2%), Panera (+1.7%), Papa John's (+5.5%), KFC (+4%), Popeye's (+1.5%), McDonald's (+1.3%), Starbucks (+4%), Wendy's (+1.4%), Wingstop (+4.1%), and Zoe's (+2.4%) all showed SSS gains. While Sonic (-2.0%), Noodles (-0.7%), Papa Murphy's (-5.8%) suffered negative SSS.

The various pockets of success speak to the need to constantly challenge your current thinking and find new, if subtle ways to innovate and/or differentiate. One good example this quarter is Del Taco (+6.7%). They've leveraged innovation, freshness cues and value in QSR. Del Taco's stellar performance in an otherwise tough market is remarkable. The large California footprint means expensive real estate, minimum wage hikes, and a regulatory environment resembling Western Europe in a market of some 37 million consumers. Yet, they've figured it out.

Paul Murphy, CEO Del Taco summarized *"Our strong fiscal third quarter performance is a direct result of the success of our Fresh Combined Solutions strategy and UnFreshing Believable 2.0 campaign....showcasing Del Taco as an innovator within the QSR segment. Through the use of fresh ingredients and product innovation served with the speed and convenience of a drive-thru, we are further differentiating our iconic brand and broadening our appeal."*

Among the patterns observed with those brands continuing to grow sales, is they are continuously working to either create new customer occasions, or differentiate the experience. Let's take a look at three brands (Wingstop, Jack in the Box, and Starbucks), each of which is pursuing its own unique, and successful, strategy for growth.

Wingstop is focused on a fast casual, national footprint, wings experience. The driver is their mission to "serve the world flavor." Important consumers are comprised of families, millennials, along with "flavor cravers." The belief is that they can be positioned in between bar-centric, QSR Chicken, pizza delivery and smaller regional brands as being the "wing experts." Two

important elements for Wingstop - social engagement and technology. Over 17% of their orders are generated online, which have a \$4 higher average check than the in-store orders.

Jack in the Box's (JIB) brand strategy is comprised of a focus on feeding “your cravings quickly and easily” with “whatever you want, whenever you want it.” Recent innovations include “Brunch Fast,” an enhancement to all day breakfast and “Jack’s Munchie Meal” - their late night offering. They’ve established a long-term vision to be at a QSR Plus positioning by 2020. If successful, the identified direct competitive set becomes In ‘N Out, Whataburger, and Chik Fil A, each of whom have industry leading Average Unit Volumes (AUV) north of \$2.5 million. Today JIB is at around \$1.5 million AUV, so there’s plenty of upside for them. We’ll see how they do.

Starbucks is not afraid to try new things and will take risks. In an effort to establish new occasions by growing the evening business, the happy hour/beverage alcohol program was established, which has not been successful overall. Going forward, they’re more focused on staying inside their established realm of credibility with coffee, tea, other non-alcoholic beverages and the food offerings.

A technology leader, there are now 12 million members in the Starbucks Rewards Program, and just over 40% of all transactions are paid for by some type of rewards card (Starbucks and others) or some type of mobile pay. A Starbucks VISA Debit card will roll out in the Q1 2017.

Most recently Starbucks had \$6 Billion in pre-paid revenue. A big advantage is the per-transaction cost on the prepaid cards, which is 1/3 the cost of debit or credit. Of course everyone in the industry is well aware of that, and the ensuing work around those initiatives will continue.

Even with all the innovation and new initiatives, Starbucks primary emphasis remains on the partners - the individuals who bring the brand to life, one transaction at a time.

Legacy casual dining continues to struggle. One example is Red Robin, which suffered a 3.6% company same-store sales (SSS) decline (2.4% traffic drop and 1.2% drop in average check). The big issue for casual dining remains the same - declining traffic and in some cases, lack of true differentiation.

Their peers suffered as well, again. Across the segment, challenges continue with Applebee’s (-5.2%), BJ’s (-3.4%), Buffalo Wild Wings (1-.8%), Chili’s (-1.4%), and Ruby Tuesday (-2.7%) - all struggling with declining traffic. Some have been able generate modest SSS increases with price, but that approach is short lived.

Yet there are some favorable results as well, led by two unique brands - Dave N’ Busters (+5.9%) and Texas Roadhouse (+3.4%). These results are especially impressive given the traffic issues overall for the category. Bonfish Grill (+1.7%), Cheesecake Factory (+1.7%), Cracker Barrel (+1.3%) and Olive Garden (+2.6%) generated, hard won, positive SSS.

Long-time Buffalo Wild Wings Chief Strategy Officer Kathy Benning left the company in October. She was one of three leaders (Former CFO, Mary Twinem who retired earlier this year, and President/CEO Sally Smith), who led the brand’s growth over a 20 year period. All three are

examples of industry leaders who left their mark on the business. This team drove the growth of the modern sports bar as we know it today.

The reality of the across-the-board individual health insurance premium increases for everyone is a problem. One way or another, those increases will mean less disposable consumer dollars available for restaurant spending. And then are the minimum wage increases, which have an immediate impact on profitability.

These unprecedented increases, combined with the ire and acrimony on the national political stage, even weeks after the election is over, create a disconcerting tone for many consumers. Unfortunately, there doesn't appear to be any signal that these patterns will ease up any time soon. Now, more than ever, regularly listening to your consumers is paramount.

3rd Quarter 2016 SSS Sales by Brand

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited / Quick Service				
Bojangle's	+0.8%			Traffic declines acknowledged
Chipotle	-21.9%	-17.9%		Troubles continue
Del Taco	+6.7%	+2.3%	+4.8%	+1% favorable mix
Domino's	+13%			5 ½ years of consecutive SSS increases
Dunkin Donuts	+2.0%			
El Pollo Loco	+1.6%			@167 Co. stores, @ 237 franchise stores
Habit Burger	+0.2%	-2.4%	+2.6%	Traffic declines
Jack in the Box	+1.1%			Average check +3.5% at Company stores
Jamba Juice	-1.1%			
KFC	+4%			New product news, combined with advertising efforts
McDonald's	+1.3%			
Noodle's	-0.7%			
Panera	+1.7%			
Papa John's	+5.5%			
Papa Murphy's	-5.8%			
Pizza Hut	-3%			
Popeye's	+1.5%			
Pollo Tropical	-1.0%	-2.5%		Closing ten restaurants
Pot Belly	+0.6%			
Qdoba	+0.6%	+0.4%		
Shake Shack	+2.9%			26 Restaurants
Sonic	-2.0%			
Starbucks	+4%			

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Taco Bell	+3%			
Taco Cabana	-4.1%	-3.5%		
Wendy's	+1.4%			
Wingstop	+4.1%			
Zoe's	+2.4%			
Full Service				
Applebee's	-5.2%			
BJ's	-3.4%			
Bob Evans	-1.8%			
Bonefish Grill	+1.7%			
Bravo Restaurants	-8%			How much longer can these brands survive?
Brick House Tavern	-8.9%			
Brio Restaurants	-3.7%			Negative sales trends continue
Buffalo Wild Wings*	-1.8%*			*-1.8% @ 608 Co. stores, -1.6% @ 595 Franchised
Capital Grill	+1.2%			
Carraba's	-2.1%			
Cheesecake Factory	+1.7%			
Chili's*	-1.4%	-4.1%	+1.2%	+1.5% favorable mix shift
Chuy's	+0.3%	-0.8%	+1.1%	
Cracker Barrel	+1.3%	-1.7%	+3.0%	
Dave 'N Busters	+5.9%			Lapping +8.8%
Denny's	+1%			
Famous Dave's	-1.0%			
Fleming's	-1.9%			
IHOP	-0.1%			
Joes' Crab Shack	-6.5%			17 Restaurants closed this year
Longhorn	+0.1%	-1.1%	+1.5%	-0.3% mix decline
Olive Garden	+2.6%	0	+2.6%	+1.4% price, +1.2% favorable mix
Outback	-0.7%			
Red Robin	-3.6%	-2.4%	-1.2%	
Ruby Tuesday	-2.7%			
Ruth's Chris	+2.1%	-1.5%	+3.6%	
Steak 'n Shake	+0.2%	-0.2%		
Texas Roadhouse*	+3.4%*			*408 Co. Stores +3.3% @73 Franchise Stores
Yard House	+0.7%			

Implications for Manufacturers

Everyone wants to be at the table or in the know when their important customers are having significant discussions about the menu/supply chain around their categories. You want to know

sooner rather than later what's happening and why - how are decisions really made and who is making them?

That's the challenge everyone faces in the chain restaurant segment. Too many development projects, in fact most of them, don't bear fruit. You're not alone! Here's one way we've helped manufacturers do better with that problem.

It's simply the rigor and discipline of your own targeting and prioritization model which is essential. This tool really helps when making those critical decisions for all the relevant opportunities. This won't and can't eliminate the serendipity, uncertainty, or changes in customer behavior patterns, but it can help mitigate at least some of it.

When the well-qualified opportunities come up, by all means, pursue them seriously. When they aren't well qualified, you can make the decision to pursue them **or not** with greater confidence for right reasons. Those decisions have their time and place - the hard part is either saying no professionally, or knowing when **not** to move forward. That's when your judgment and skill matter.

If you're struggling with these decisions, you can start by downloading our white paper on the Targeting & Prioritization Process - which is free! Additionally, we'll provide an introductory webinar on the process and how to make it work at no cost, for the first ten manufacturers who would like to learn more. Just give any of us a call.

Finally, we published our first ever Restaurant Consumer Confidence Index Report in November. We've been encouraged by all the interest. If you'd like to learn more, Mac Brand will be happy to share the details.

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