1ST HALF 2017 CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

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TO: Operator Friends & Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) First Half 2017

First Half 2017 Same Store Sales Reports

Since the inaugural edition last fall, our Restaurant Consumer Confidence Index (RCCI) has been very accurate about what was going to happen in the following quarter. In the spring, consumers told us:

- Their Casual Dining Restaurant spending was going to be down 16% overall
- Restaurant meals have a value perception issue, with 68% of consumers aged 18-34 stating that restaurant meals are too expensive. The 35+ age group was a little more positive with 58% of those consumers feeling that restaurant meals are too expensive
- Consumers believe (by 20 points) their business is more valued at independents (61%) than chains (41%)

So it came as no surprise that first half of 2017 was a mixed bag in all segments, with more bad news than good news, especially in casual dining bar and grill (more on that later). In limited/quick service there are positive trends. Panera (Q1 +5.3 %;) and Starbucks (Q1+3%; Q2 +5%) continue to perform well as does McDonald's (Q1+1.7%; Q2+3.9%). Each brand has executed its own set of innovations and tweaks to drive momentum. The consumer recognizes the differentiation and value.

Panera recently announced plans to hire 10,000 delivery drivers with *"daytime hours and competitive wages"* to bring a *"new level of enthusiasm and delight"* to their customers. They're also rolling out a new order tracking system which lets guests track their delivery order all the way to their home or office.

A guest can see expected arrival time, follow the delivery's progress on a map, see a picture of, and be introduced to, their driver, and receive a notification when their driver is arriving. In their most recent report Panera indicated that 26% of total sales are now digital, and 25% of sales in company stores are delivery.

At McDonald's, following last year's launch of All Day Breakfast, they've completed menu, value, and convenience initiatives, along with the Big Mac and beverage value promotions. In what has been described as an important cultural shift to make the company a more desirable place to work for millennials, the corporate headquarters is moving into the city of Chicago (in the same spot that used to be Harpo Studios). McDonald's sales also benefitted from the national cold beverage value promotion and the launch of the Signature Crafted premium sandwich platform.

Starbucks continues to innovate and evolve on many fronts. They have a long history of innovation. In 1988 the company began offering full health benefits to eligible full- and part-time employees, including coverage for domestic partnerships when they had 33 stores.

They've introduced the "Mercato" line in about 100 stores in the Chicago market. It is an all new lunch menu, mostly salads and sandwiches. Each item is prepared with natural ingredients, including breads and cheeses, veggies, grains and greens. What's not sold each day is donated nightly to the "community." There's a separate food test in Houston, with Snap Kitchen.

The hiccups with the mobile ordering program, which has caused longer than expected wait times for some customers who actually order in the store, have been acknowledged. CEO Howard Schultz was very proactive in addressing the issue early in January, saying in part *"We'll get it figured out."*

Del Taco (+4% Q1; +6.9% Q2) continues to deliver impressive performance. Business driving initiatives included a shrimp LTO, a refresh of the breakfast menu in March, and dedicated marketing windows for The Del Taco and Platos, as well as a Carnitas LTO.

The one consistent painful story is Casual Dining Bar & Grill. The two largest players, Chili's (-1.7% Q1, -6.2% traffic; -2.2% Q2, traffic-6.5%) and Applebee's (-7.9% Q1; -6.2% Q2) continue to suffer sales and traffic declines. Applebee's announced plans to close at least 105 restaurants this year. It's anyone's guess where the bottom will be.

At the same time, we found Red Robin Gourmet Burgers has established an interesting strategy. Red Robin has provided the details of a comprehensive off-premise approach in a recent investor presentation. The fundamental approach is based on solid principles - "*Consumers expect to get their food when, where and how they want it*" and that "*Restaurants must learn from retail."* Among their keys to success is *"seamless accessibility."*

The rationale is based on research that indicated 50% of their consumers say making burgers as available as pizza would increase their frequency. In Red Robin's case, they're at about half the industry average for off-premise sales, so the belief is that gap can be exploited. We'll keep watching and see how they do. The big unknown is if 3rd party delivery is the most effective approach. Of course, if they're successful, plenty of their competitors will follow. Most are already working on their own delivery initiatives, which track with the growth numbers from RCCI for take-out and delivery.

Some others in Casual Dining had favorable SSS. The two iconic Darden Brands, Longhorn (+3.5% Q1) and Olive Garden (+4.4% Q1) had positive first quarters, and more importantly traffic gains of around 2% for both brands. We now can report Cheddars' performance (now part of Darden) at +0.3% in the first quarter.

Once again Dave & Buster's continues to stay positive (+2.2% Q1; +1.1% Q2), providing consistent solid performance - especially given their AUVs of $11.6 million.

Pizza is still a story of winners and strugglers. Domino's (+10.2% Q1; +9.5% Q2) is still outperforming the industry, and is a remarkable story. Papa John's remained positive (+2% Q1; +1.4% Q2), driven by the technology enhancements. Both Papa Murphy's (-5% Q1; -4.3% Q2) and Pizza Hut (-6% Q1; -4% Q2) had difficult first six months. The question for Pizza Hut is what to do about the legacy "Red Roof" restaurants, most of which are owned by their franchisees (7,200 of the 7,770 domestic stores). That's a lot of re-models.

The overall slowdown has impacted even the fast causal brands. Shake Shack (-2.5% Q1; -1.8% Q2), Zoe's (-3.3% Q1; -3.8% Q2), and Pot Belly (-3.1% Q1; -4.9% Q2) all experienced negative SSS. Qdoba (-3.2% Q1; +0.5% Q2) did have a modest gain in Q2, following a tough first quarter. Part of the challenge is that all the brands execute really well, and consumers easily tire of new experiences, even with new brands. That's on top of the restaurant caliber offerings in the prepared food sections of most grocery stores today.

RCCI panelists have consistently told us they feel more valued at their local restaurants than at chain restaurants. They told us in both January and April that there are often *"better value"* prepared food options in grocery stores. The impact of this perspective combined with the innovation in fast casual and the growing delivery options are all competitive factors.

The competition for the away from home meal is all around, all the time. There's Costco which is now the 65th largest chain restaurant when measured by total units domestically. The Costco quick service business is now at $ 1.6 million average unit volume (AUV). When measured by AUV – Costco is the #42 Brand in the Top 100 Chains. Costco's AUVs are at par with, or even higher than, a number of full-service and quick service brands - Ruby Tuesday's, Denny's, Wendy's, and Jack in the Box are just a few examples. This is with $3 hot dogs and other value priced menu items.

JAB Holdings continues their consolidation of the coffee and bakery chain business by purchasing Bruegger's Bagels from Le Duff North America.

*SSS listed below are those reported for the first half of 2017 (unless indicated otherwise)

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
		Limited / Quick Service		
Bojangle's	-1.5%			
Burger King	+0.4%			
Chipotle	+12.5%			
Del Taco	+5.5%			
Domino's	+9.8%			
Dunkin Donuts	+0.4%			
El Pollo Loco	+1.3%			
Habit Burger	+0.5%			
Jack in the Box	-0.5%			
Jamba Juice	+0.5%			Lapping -6.5%
KFC	1.5%			
McDonald's	+2.8%			
Noodle's	-2.7%			
Panera	+5.3%			Q1 2017* Acquired by JAB Holdings
Papa John's	+1.7%			
Papa Murphy's	-4.6%			Negative trends continue
Pizza Hut	-5%			
Pollo Tropical	-7.2%	-9.4%		
Popeye's	-1.7%			Acquisition by RBI completed
Pot Belly	-4%			Long time President Alwyn Lewis stepping down
Qdoba	-1.4%			
Shake Shack	-2.1%			
Sonic	-1.2%			
Starbucks	+4%	+0.5%	+3.5%	
Taco Bell	+6%			
Taco Cabana	-4.6%	-4.2%		
Wendy's	+2.4%			
Wingstop	+0.5%			946 Domestic Franchised Stores, 21 Company stores
Zoe's	-3.6%	-4.8%	+1.3%	
		Full Service		
Applebee's	-7%			Lapping a -3.9% SSS
BJ's	-1.3%			
Bonefish Grill	-1.7%	-2.6%	+2.5%	
Bravo Restaurants	-2.0%			
Brio Restaurants	-1.4%			
Buffalo Wild Wings*	-0.35%			*635 Co. Stores; -0.75% @ 624 Franchised Stores
Capital Grill	+0.5%			Q1 Report
Carraba's	-1.7%	-4.6%	+2.9%	

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Cheddar's	+0.3%			Q1 Report
Cheesecake Factory	-0.75%			
Chili's	-1.9%	-6.3%	+2.9%	Lapping -4.5% traffic decline First Half 2016
Chuy's	-0.85%			
Cracker Barrel	-0.6%	-1.9%	+1.3%	
Dave 'N Busters	+1.6%			
Del Frisco's Double Eagle	Flat	-1.75%	+1.25%	
Denny's	+1.5%			
Famous Dave's	-3.7%			
Fleming's	-2.1%	-6.5%	+4.4%	
IHOP	-2.1%			
Longhorn	+3.5%	+2.1%	+1.3%	+0.1% Favorable Mix (Q1 Report)
Olive Garden	+4.4%	+2%	+1.7%	Q1 Report
Outback	+0.8%	-1.5%	+2.3%	
Red Robin	-0.3%	0.3%	+1.1%	
Ruby Tuesday	-2.8%			Company stores
Ruth's Chris	+1.8%	+.2%	+1.6%	
Seasons 52	-1.3%			Q1 Report
Steak 'n Shake	-3.2%	-3.4%		
Sullivan's Steak House	-0.7%	-0.45%	-1.1%	
Texas Roadhouse*	+3.6%			*428 Company stores; +3.7% @ 70 Franchised Stores
Yard House	+0.1%			Q1 Report

<u>Implications for Operators</u>

Delivery is now a lever many operators are using to drive the business. From what we've seen and heard from consumers so far, it appears to be something that matters today, and will likely matter more over time. We've seen this pattern with other innovations, as the new offering begins as a competitive advantage for the innovative operators while then evolving to be something consumers expect as part of the overall offering.

The big decision for many operators is whether to have their own staff or rely on third party delivery. Beyond cost, the issue is who do you want delivering on your Brand Promise - an outside third party or someone who is invested in your success?

We can have all the discussions about the cost, liability, training, and the other challenges of adding additional headcount. The reality is that if it becomes something consumers expect and/or a driver of loyal or preference, you'll have to have a solution to remain relevant.

We’ve now validated that the data in our Restaurant Consumer Confidence Reports is, in fact, predictive. If you’d like to learn more, Mac Brand will be happy to share the details.

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