1ST QUARTER 2017 CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

DATE: July 2017

TO: Manufacturer Friends & Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 1st Quarter 2017

1st Quarter 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 January consumers told us:

- Their Casual Dining Restaurant spending was going to be down 16% overall
- That 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 quarter 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 (+5.3%) and Starbucks (+3%) continue to perform well as does McDonald's (+1.7%). 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).

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 sandwich. 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 separate food test in Houston, with Snap Kitchen.

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

The one consistent painful story is Casual Dining Bar & Grill. The two largest players, Chili's (-1.7% SSS, -6.2% traffic) and Applebee's (-7.9% SSS) continue to suffer sales and traffic declines. 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 tracks 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 and Olive Garden, have positive (+3.5%; + 4.4% respectively) SSS gains, and more importantly traffic gains (+2%, +2.1% respectively). We now can report Cheddars' performance (now part of Darden) at +0.3%.

Once again Dave & Buster's continues to make it work – reporting a +2.2% SSS, which is strong - especially given their AUVs of $11.6 million.

Pizza is still a story of winners and strugglers. Domino's (+10.2%) is still outperforming the industry. Papa John's remained positive (+2%), driven by the technology enhancements. Both Papa Murphy's (-5%) and Pizza Hut (-6%) had difficult quarters. 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%), Zoe's (-3.3%) Qdoba (-3.2%), and Pot Belly (-3.1%) all experienced negative SSS. 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 January 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.

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited / Quick Service				
Bojangle's	-1.7%			
Burger King	-2.2%			
Chipotle	+17.8%			
Del Taco	4%			
Domino's	+10.2%			
Dunkin Donuts	Flat			
El Pollo Loco	-0.3%			
Habit Burger	+0.9%			
Jack in the Box	-0.8%			
Jamba Juice	-2.2%			Last reported SSS March 2017
KFC	+2%			
McDonald's	+1.7%			
Noodle's	-2.0%			

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Panera	+5.3%			Acquired by JAB Holdings
Papa John's	+2.0%			
Papa Murphy's	-5.0%			
Pizza Hut	-6%			
Pollo Tropical*	-6.7%	-8.9%		
Popeye's	-0.2%			Acquired by Restaurant Brands International
Pot Belly	-3.1%			Alwyn Lewis stepping down
Qdoba	-3.2%			
Shake Shack	-2.5%	-3.4%	+0.9%	
Sonic	-1.2%			
Starbucks	+3%	Flat	+3%	
Taco Bell	+8%			
Taco Cabana	-4.5%	-4%		
Wendy's	+1.6%			
Wingstop	-1.1%			
Zoe's	-3.3%	-4.6%	+1.3%	
Full Service				
Applebee's	-7.9%			Lapping a -3.7% SSS
BJ's	-1.3%			
Bonefish Grill	-0.8%	-2.2%	+1.4%	
Bravo Restaurants	-2.9%			
Brio Restaurants	-1.9%			
Buffalo Wild Wings*	+0.5%			*634 Co. Stores; +0.6% @ 616 Franchised Stores
Capital Grill	+0.5%			
Carraba's	-3.8%	-7.2%	+3.4%	
Cheddar's	+0.3%			
Cheesecake Factory	-1%			
Chili's	-1.7%	-6.2%		Lapping -4.9% traffic
Chuy's	-0.7%			
Cracker Barrel	-0.4%	-2.1%	+1.7%	
Dave 'N Busters	+2.2%			
Del Frisco's Double Eagle	+0.5%	-1.2%	+0.7%	
Denny's	-1.1%			
Famous Dave's	-4.5%			
Fleming's	-2.9%	-7.5%	+4.6%	
IHOP	-1.7%			
Longhorn	+3.5%	+2.1%	+1.3%	+0.1% Favorable Mix
Olive Garden	+4.4%	+2%	+1.7%	+0.7% Favorable Mix

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Outback	+1.4%	-2.1%	+3.5%	
Red Robin	-1.2%	-1.7%	+0.5%	
Ruby Tuesday	-4.0%			Company stores
Ruth's Chris	+0.7%	-1.7%	+2.4%	
Seasons 52	-1.3%			
Steak 'n Shake	-3.3%	-2.4%		
Sullivan's Steak House	+1.1%	+1.9%	-0.8%	
Texas Roadhouse*	+3.1%			*423 Co. Stores, +3.8% @ 70 Franchised Stores
Yard House	+0.1%			

Implications for Manufacturers

We're often asked our view about two issues. The first is an approach to actually grow the business in this environment. The second is around how to get the best ROI on sales talent in this flat market.

The way to try to grow the business is to focus on the new, brand new business development function. Simply put, a team or an individual focuses on completely new business. Someone with no active accounts is given the assignment to assess, and then execute against new opportunities.

This is not the traditional national accounts manager, product seller or even a solution driven sales person. This professional can do the analysis, assess the opportunities, identify the risk/reward scenarios, understand segment growth patterns, understand the customer brand, and use all of that information to set solid priorities, and connect with new prospects.

Getting a better ROI on your sales investment is actually pretty simple. Some manufacturers are just not filling open operator or chain account sales manager sales positions. When a national accounts manager leaves the firm, existing customers and new business pipelines are divided up amongst the remaining staff. The reality is that there just aren't as many well-qualified new, potentially profitable, large opportunities on the horizon.

Finally, many manufacturers continue to re-evaluate the time, energy and money spent on conferences of little value. In this environment, why anyone would participate in any type of purchasing focused conference is puzzling.

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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