QUARTERLY CHAIN RESTAURANT UPDATE

BELLWETHER FOOD GROUP, Inc.

DATE: July 11, 2014

TO: Manufacturing Friends and Colleagues

FROM: Bellwether Food Group

RE: Chain Restaurant Same Store Sales (SSS) 1st Quarter, Calendar Year 2014

The 1st Quarter 2014 Same Store Sales Reports

Record cold weather hurt many brands, especially those with a strong presence in the colder climates. Yet some brands did well regardless. The pizza delivery brands actually benefitted from the extreme weather, with every brand in the category performing well, led by Papa John's with a +9.6% – pretty good in a mature category. Cold weather was not a problem for Miami based Pollo Tropical which posted a 6.3% SSS increase, driven by a 4.6% increase in traffic. Sonic posted a +5.3% SSS, driven by increased media efficiency, innovative products and layered day-part promotions.

Red Robin, IHOP, Denny's and others all had positive quarters despite the weather.

Brands that are not part of enough consumers' regular individual rotation are the ones that suffered the most. In looking at the full service brands, a number had tough quarters. BJ's, Macaroni Grill, Joe's Crab Shack, Red Lobster, Olive Garden, all struggled. Each brand is unique and has its own strengths and weaknesses. At the same time, the weather certainly was a factor. These brands seem to suffer most when consumers are distracted by weather and are less likely to brave the elements for a full service meal, especially dinner.

Brands that are a daily habit like Starbucks, Dunkin Donuts and others posted gains. The other pattern in evidence is if you're the place consumers go when it's too cold to go anywhere else (like Buffalo Wild Wings for NFL Playoffs and College Basketball), then you have a chance to sustain traffic, even with record cold.

For market leadership – it starts with the fundamentals of the brand and the confidence of the management team, and to a large extent their talent. How well the management team works together is a key factor. The message of cross functional collaboration (or lack of) sets a tone for the entire organization.

In looking at the leaders of the last few years — many have taken a leadership stance with the consumer. One example, McDonald's and the espresso based drinks. Remember all the consternation and noise around disgruntled franchisees and the cost of the machines? That those drinks wouldn't sell in markets like Des Moines, Albany or Fresno – all of this five years ago? Guess what, those drinks are doing actually pretty well in most cases. The real learning is that McDonald's was a safe environment for some consumers to try a Cappuccino or Latte, and they've since become regular consumers of those drinks. This is important for at least two big reasons. First, the espresso-based beverages are one small way to compensate for the lost soft drink sales, and those types of beverages are often separate snacking and beverage consuming occasions. More traffic equals more revenue.

In terms of leading the consumer, Chipotle (+13.4% SSS) continues to push the envelope on sustainable and local sourcing, something no other brand is even close to doing. Under Steve Ells' leadership they continue to push the supply chain envelope. In 2013 they purchased 15 million pounds of locally grown produce. Their goal for 2014 is 20 million pounds. Those actions say to consumers that Chipotle is on a constant quest to upgrade the "fast casual" experience.

One example on culinary is Popeye's Louisiana Kitchen. They're all about the unique flavors and food experience of Louisiana. They're proud of it and don't make excuses about their nutritionals. When the consumer makes the decision to go to Popeye's, they've already decided to go for flavor and the experience Popeye's offers.

We had the opportunity to sit in on Popeye's CEO Cheryl Bachelder's presentation in June at the Piper Jaffray conference (where our own Jon Jameson presented the emerging brands research!). Under her direction and leadership Popeye's continues to do well. Their unit growth plans domestically are aggressive, but reasonable and well thought out.

There was some consternation in the financial press about McDonald's "softness" in the first quarter. Frankly, that is a bit out of context. Yes they did experience negative same store sales domestically. Putting that performance in context, we see it differently.

The fact is that over the past ten years, they have led the marketplace in many innovations. This includes espresso-based drinks(none of their other direct competitors have those), salads, McWraps, and egg whites of all things. Over the past ten years, the average AUV has grown by $800,000 annually - from $1.8 million to $2.6 million today. Their closest competitors in hamburger QSR (Wendy's $1.5 Million AUV and Burger King $1.3 million AUV) are far behind in sales per unit. Essentially, one McDonald's does double the volume of a Burger King. If you're doing business with McDonald's, don't worry about the overall health of the brand.

1st Quarter 2014 SSS Sales by Brand

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Limited/Quick Service				
Burger King	+0.1%			
Chipotle	+13.4%			
Domino's	+4.9%			
Dunkin Donuts	+1.2%			
Einstein’s	+1.6%			
Jack in the Box	+0.7%			
McDonald's	-1.7%			
Panera*	+0.1%			
Papa John's	+9.6%			
Popeye’s	+4.3%			
Pollo Tropical	+6.3%	+4.6%		
Sonic	+5.3%			
Starbucks	+6.0%	+2.0%	+3.0%	+1% Mix shift
Taco Cabana	+0.8%	-2.0%		
Wendy's	+1.3%			
KFC	-3.0%			
Pizza Hut	-5.0%			
Taco Bell	-1.0%			
Full Service				
Applebee's	-0.5%			
BJ’s	-2.9%			
Bob Evans	-4.1%			Original 1st QTR release was postponed 6 weeks
Bonefish Grill	-1.5%			
Bravo Restaurants	-5.5%			
Brio Restaurants	-4.4%			
Buffalo Wild Wings	+6.6%			*443 Company stores, +5.0% at 569 franchise stores
Carraba’s	-1.8%			
Cheesecake Factory	+1.2%			
Chili's	+0.7%			
Chuy’s	+4.2%			
Cracker Barrel	-0.6%			
Denny's	+1.8%			
Famous Dave’s	-4.9%			Lapping a -1.3%
Fleming's	+1.7%			
IHOP	+3.9%			
Joes’ Crab Shack	-6.0%			

Brand	Same Store Sales Versus Prior Year	Traffic Change	Pricing	Comments
Longhorn	+2.4%			
Macaroni Grill	-4.1%			
Olive Garden	-3.5%			
Outback	+0.8%			
Red Lobster	-5.6%			
Red Robin	+5.4%			
Ruby Tuesday	-1.9%	-1.7%		*703 Company stores (-2.2% at 75 franchised stores)
Ruth's Chris	+2.6%			
Steak ‘n Shake	+3.7%	+2.9%		
Texas Roadhouse	+2.8%			*345 Company stores, at 74 franchised stores)

Implications for Manufacturers

Be very selective these days about which accounts to invest in. Even Taco Bell, with a great track record (and from what we hear a pretty reasonable brand to work with on the development side), looks at 3,000-4,000 “ideas” each year. Between 200-300 make it to market test, and then there’s maybe 6-8 new products that actually get on the menu. We’re not suggesting you don’t call or work with big brands, surely you should. However, be realistic about the chances of success going in – even if you do everything right. Do this based on your targeting and prioritization tool, as well as understanding the brand positioning and menu innovation strategies.

The point here is to know the evaluation process, the metrics, the brand, the culture – all of it matters. We’re still hearing some manufacturers talk about the “*upside sales potential”* to their chain targets when talking about, or trying to sell in, new products. Avoid that approach for three reasons.

First, many manufacturers come in with that pitch, so no one ever believes the “projections” and they all sound the same. You get lost in the sea of typical presentations from manufacturers who don’t know the restaurant brand or the business. Second, the first consideration for the customer is this: does your offering fit within the brand strategy and framework and the experience(s) they want to deliver to the consumer. You need to get clarity around that important point before going in with any presentation. Third, most of the chains are not trying to “upsell” per se. They would much rather gain incremental visits from existing or lapsed consumers. If you can help with that – then you really have something to talk about!

We’re encouraging our manufacturing clients to identify some growing brands to focus on (examples – First Watch, Noodles & Co., and even Popeye’s). The rationale is that the larger brands often look to emerging brands for ideas. This is somewhat different than in the past where it was often the other way around – smaller brands trying to imitate the larger, more established brands. And of course the growing brands have plenty of room for continuing to open new restaurants.

Proceed cautiously if you're working on Famous Dave's. There's a tremendous amount of turmoil there, driven by declining sales, management changes, traffic issues and others. Beyond that, their fundamental challenge is the regional preferences in barbecue combined with low consumer frequency in their upper Midwest trade areas. Those are tough headwinds.

As always, we look forward to your thoughts and feedback.

Regards,

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