TULLY & HOLLAND
INCORPORATED

Restaurant Industry Update

RESTAURANT INDUSTRY

December 2013

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EXECUTIVE SUMMARY

The restaurant industry experienced modest growth during the first three quarters of 2013, with consumer confidence and consumer spending impacted by the recent government shutdown, debt ceiling crisis and sluggish job recovery.

The American consumer has remained confident despite the economic headwinds of 2013, as discretionary spending continues to rise. Consumers are increasingly more confident about disposable income levels, with nominal restaurant sales rising 4.2% to $425.6 billion in 2012, with sales projected to rise 3.8% to $441.9 billion by the end of the year. The fast casual sector has been the biggest driver of this growth, fueled by consumer demand for high quality, fresh food in a convenient and comfortable setting.

A strong interest from financial buyers, as well as urgency on the part of sellers to consummate a transaction before changes in capital gains tax rates transpired, contributed to stable restaurant M&A in 2012. Sales of established franchise operations dominated deal volume, while private equity groups became active investors in fast casual and quick service concept chains.

M&A ACTIVITY

Total restaurant M&A volume through December 2013, was on pace to meet similar volume from 2012, suggesting a stable acquisition market in spite of numerous concerns facing the restaurant industry, including health care, consumer confidence and minimum wage and payroll tax issues. As of December 1, 2013, eighty-four restaurant transactions closed, compared to 96 total restaurant transactions in 2012.

Middle-market restaurant M&A, defined as operations with less than $500 million in annual sales, has been sluggish in 2013. Compared to overall industry-wide M&A, the middle-market continued to struggle, with only eight restaurant change of control transactions occurring through November 2013, compared to 15 total middle-market change of control transactions in 2012.

Private equity investors were involved in 34% of all restaurant chain transactions in 2013, an increase of eight percentage points from the prior year. Fast casual concept-chains, benefitting from the steady shift in consumer preference for higher quality food at competitive prices, continue to attract significant interest from both financial and strategic acquirers.

Patrick T. Keefe
Director
781.239.2900 x20
pkeefe@tullyandholland.com

20 William St.
Suite 135
Wellesley, MA 02481
tullyandholland.com

M&A ACTIVITY

The following table highlights recent significant restaurant transactions.

	Target	Restaurant Segment	Buyer	Enterprise Value ($ in millions)	Enterprise Value as a Multiple of LTM Revenue	EBITDA
10/08/2013	Captain D's	Casual	Centre Partners	$175	NA	5.8x
7/22/2013	Miller's Ale House	Casual	Roark Capital Group	$315	1.05x	NA
6/18/2013	The Johnny Rockets Group, Inc.	Fast Casual	Sun Capital/Friendly's	$90	NA	NA
5/28/2013	Mastro's Restaurants	Fine Dining	Landry's Holdings	$220	1.69x	10.0x
2/16/2013	Romano's Macaroni Grill	Casual	Ignite Restaurant Group	$54	.14x	NA
1/28/2013	Mimi's Café	Casual	Le Duff America, Inc.	$50	.13x	NA
12/17/2012	Caribou Coffee Company, Inc.	QSR	BDT Capital and JAB Beech	$310	.94x	11.4x
7/31/2012	Taco Mac	Casual	CIC Partners	$130	NA	10.0x
7/12/2012	Yard House USA, Inc.	Casual	Darden Restaurants, Inc.	$585	1.79x	13.9x
6/25/2012	J. Alexander Corp.	Casual	American Blue Ribbon Holdings	$100	.62x	9.0x
5/22/2012	Benihana	Casual	Angelo, Gordon & Co.	$275	.78x	9.1x
2/6/2012	O'Charley's	Casual	American Blue Ribbon Holdings	$198	.24x	5.3x
				Median	.7x	9.1x
				Mean	.82x	9.31x

THE GROWTH OF PRIVATE EQUITY

PRIVATE EQUITY CHASING FAST CASUAL CONCEPTS

While there have been relatively few middle-market change of control transactions in 2013, institutional investors have shown an increased desire to make growth equity investments. Since 2007, private equity groups have been the dominant player in all restaurant chain transactions, accounting for 31% of total M&A volume within the restaurant sector.

Since the economic downturn and leading up to 2012, private equity groups remained cautious and selective toward the restaurant sector, where a restaurant chain had to be a certain size or have a certain valuation to attract the attention of investors. Beginning in early 2012, with private equity groups hungry to put capital to work, institutional investors aggressively pursued the high-growth opportunities of fast casual and quick service concept chains. Many of the retail and consumer-focused private equity funds made one or more investments in restaurants from 2012-2013. These included private equity investors Catterton Partners, Brentwood Associates, Leonard Green, Beekman Group, and Gridiron Capital. Four key factors positively impact interest and valuations from private equity buyers:
1) a clearly differentiated concept and/or food service offering; 2) a capable, continuing management team enthusiastic on growing the business, 3) strong store level economics, and 4) an ability to scale to a larger business.

PRIVATE EQUITY INVESTMENTS

The following table highlights recent significant private equity investments made in restaurant concepts over the past 12 months.

Date	Investor	Restaurant Chain	Transaction Details
10/1/2013	Catterton Partners	Protein Bar	$22 million investment in a 12-unit protein-focused chain of healthy fast food restaurants.
9/30/2013	Catteron Partners	Bruxie	4-Unit gourmet waffle sandwich concept based in Orange, CA.
9/27/2013	Catterton Partners	The Piada Group	14-Unit Ohio-based fast casual Italian restaurant chain.
5/28/2013	Catteron Partners	Snap Kitchen	10-Unit healthy takeaway concept.
7/29/2013	Brentwood Associates	Lazy Dog Restaurant & Bar	12-Unit West Coast-based casual restaurant chain.
7/9/2013	Beekman Group	Ted's Café Escondido	6-Unit Tex-Mex casual dining chain based in Oklahoma City.
5/1/2013	Gridiron Capital	Tokyo Joe's	25-Unit fast-casual modern Asian themed restaurant chain based in Denver, Co.
1/8/2013	Morehead Capital	Chop't	$41 million investment in a 22-unit fast casual salad chain.
1/4/2013	Catterton Partners	Primanti Brothers	20-Unit Pittsburgh, PA-based sandwich chain.
12/28/2012	Brentwood Associates	Veggie Grill	$20 million growth equity investment for the 7-unit vegan chain.

FAVORABLE BORROWING CONDITIONS

While private equity investors continue to show an active interest in middle-market restaurant deals, there are also significant opportunities and flexible options available for debt financing. The current conditions in the debt markets have created favorable borrowing opportunities for restaurant operators due to low interest rates, improving economic conditions and commercial banks and alternative lenders competing to put capital to work.

Because middle-market M&A activity has been slow in 2013, capital for financing acquisitions is readily available. With lenders aggressively seeking to make loans, coupled with strong valuations and a finite number of quality deals, operators should be considering how debt fits into their current capital structure and their overall plans for growth. For restaurant operators that are seeking capital for either acquisitions, organic growth or to refinance their existing debt, now is the time to consider the options.

VALUATION

Strong valuations in the restaurant sector continue to be fueled by a plethora of capital and the eagerness of institutional investors to put that capital to work. Based on transaction data over the last two years, the median enterprise value to EBITDA multiple was 9.3x for restaurant chains under $500 million in deal size. Institutional investors were the primary driver of premium purchase prices, paying multiples of eight to 10 times EBITDA for fast casual and growth oriented companies and franchisors.

Publicly traded companies in the restaurant sector provide additional valuation guidance. Restaurant chains in the fast casual segment (defined as operations with limited services and take-out restaurants with limited menus and no table service) traded at an average enterprise value to EBITDA multiple of 19.1x. Full-service restaurant chains (defined as family restaurants and casual and high-end dining establishments) traded at an average enterprise value to EBITDA multiple of 9.1x. Given that these multiples reflect large publicly traded companies, we could realistically apply size and liquidity discounts to determine valuations of smaller privately held companies.

The premium valuations commanded by fast casual concept chains can be attributed to their explosive growth and customer demand. Fast casual brands, which are taking market share from traditional quick serve and casual dining restaurants, grew by 7% in the past year to 15,728 total chain-operations and total restaurant traffic steadily increased by 9% in 2013.

Source: Capital IQ and Industry Publications and News Sources (e.g. PE Hub, Nation's Restaurant News, Restaurant Finance Monitor, GE Restaurant Lending Review, QSR Magazine, Chain Restaurant Merger & Acquisition Census, etc.)

ABOUT TULLY & HOLLAND

INVESTMENT BANKING SOLUTIONS FOR CONSUMER PRODUCT COMPANIES

Tully & Holland is a boutique investment banking firm that provides financial advisory services to the consumer sector. Tully & Holland consistently ranks among the nation's most active investment banks in the food, beverage, direct marketing, retail and consumer product sectors. The firm offers merger and acquisition advisory, management buyouts, private placements and valuation services. The firm focuses on the middle market and handles merger and acquisition transactions between $10 and $100 million. Tully & Holland was founded in 1992 and is a member of FINRA & SIPC.

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