

## Restaurant Industry Update

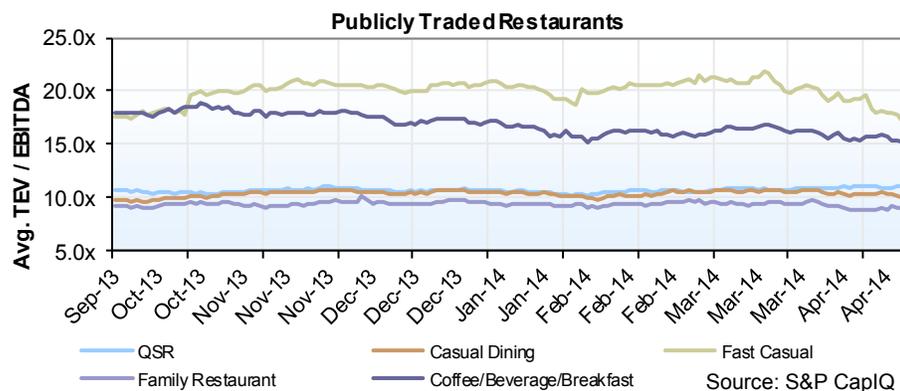
### Investors race into Fast Casual

#### EXECUTIVE SUMMARY

Substantial investment is taking place in three categories of the fast-casual restaurant segment; 1) Healthy dining chains, capitalizing on a widespread shift towards healthier consumption behaviors; 2) Premium burger chains, following the explosive growth of Five Guys Burgers; and 3) Artisan pizza concepts, attracting strategic investment from players like Chipotle and Buffalo Wild Wings. Heightened investor interest in the fast casual segment is driven by superior growth prospects and changing customer preferences towards higher quality ingredients at good value.

#### SUPERIOR GROWTH PROSPECTS

For the fifth consecutive year, the fast-casual segment's growth in traffic outpaced that of every other restaurant segment. According to the NPD Group, total customer visits to fast-casual restaurants in 2013 rose 8%; while casual dining, mid-scale restaurants and the quick-service segment recorded flat traffic growth compared to 2012. It is no surprise that publicly traded fast casual companies command substantial valuations premiums vis-à-vis casual dining.



#### INVESTORS LOWER SIZE HURDLE

Interestingly, a number of private equity firms, enamored by the tremendous growth opportunity, are going out of their way to fund early stage disruptive opportunities in the Restaurant Industry. The rebalance in investment criteria comes as a bit of a surprise, as previously investors sought out operators managing at least 10 units and a proven model of success. While unit economics continue to be important, both private equity investors and strategic buyers are becoming involved with promising concepts with fewer units in limited geographic markets.

#### RESTAURANTS

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## 'BETTER FOR YOU' CONCEPTS

Healthy dining concepts attracted the greatest interest from investors in 2013 as consumer demand for healthy, fresh foods in a convenient setting continues to grow. Fast-casual dining continues to be the fastest growing segment, with top-line growth projected to be 14.1% in 2014. Within this segment, concepts that recognized the changing eating habits of consumers and a focus on fresh ingredients are in high demand from both consumers and investors.

The following chart highlights notable investments in “better for you” dining concepts in 2013:

<u>Investor</u>	<u>Concept</u>	<u>Transaction Detail</u>
Revolution Growth		\$22 million investment in a 22-unit salad chain. Revenue of \$25 million in 2013, \$39 million of financing raised to date.
AC Restaurant Group— a newly formed Coors family company.		Undisclosed majority investment in a 11-unit Denver based soup, salad and sandwich chain.
Catterton Partners		\$22 million investment in a 12-unit protein-focused chain of healthy fast food restaurants.
TSG Consumer Partners		Minority investment in a 60-unit gluten-free healthy takeaway concept based in Austin, Texas.
Catterton Partners		\$13 million investment in a 10-Unit healthy takeaway concept.
Catterton Partners		\$24 million investment in a 6-Unit gourmet waffle sandwich concept based in Orange, CA.
Morehead Capital		\$41 million investment in a 22-unit fast casual salad chain.
Brentwood Associates		\$20 million growth equity investment for the 7-unit vegan chain.

Source: T&H research

## 'BETTER BURGER' CHAINS

"Better burger" chains have experienced substantial growth since the recession with concepts promoting local sourcing, a healthier lifestyle and premium ingredients compared to larger fast food chains. While the better-burger landscape has become increasingly more competitive, both private equity and strategic investors are demonstrating continued interest in premium burger brands with a strong regional or local footprint.

The following chart illustrates notable investments in better burger concepts in 2013:

<u>Investor</u>	<u>Concept</u>	<u>Transaction Details</u>
Fortress Investment Group		\$20 million investment in a full-service, modern themed burger concept.
Chanticleer Holdings		\$3.6m investment in a 5-unit, Charlotte, North Carolina based burger chain.
Alliance Consumer Growth		Minority investment in a modern "roadside" burger concept based in New York City, with 21 locations throughout the East Coast.
Private Investment Group		\$20 million investment from multiple investors to accelerate growth in anticipation of an IPO. Estimated EBITDA of \$15 million in 2013.

Source: T&H research

Burger concepts have expanded rapidly since the recession due, in part, to strategic investments that have facilitated both corporate and franchise expansion into new markets. Five Guys Burgers enacted aggressive franchise sales and sold out all franchise rights in 2012. As a result, the business grew to 1,171 units nationwide and established itself as the fastest growing restaurant chain in the country.

While Five Guys may be the largest "better-burger" chain by volume, significant opportunity exists in local/regional markets as evidenced by very few chains laying claim to a national presence. The 'better burger' segment as a whole shows signs of continued growth. According to Technomic's 2013 Top 150 Fast Casual Chain Restaurant Report, burger concepts posted 15% sales growth on unit growth of 14%.

<u>Burger Chain</u>	<u>U.S. Units</u>	<u>U.S. Locations</u>
Five Guys	1,171	47 States
Smashburger	252	30 States
Fatburger	115	CA, NV, AZ, WA, FL, CO, NJ, NY, GA, IL, MD, MI, NE & OH
Elevation Burger	40	ME, NY, PA, NJ, NY, VA, NC, FL, IN, MI, TX
Umami Burger	23	CA, FL & NY
Shake Shack	20	NY, PA, FL, DC, MA & NJ
Bobby's Burger Palace	16	CT, NY, MA, NJ, NY, OH, PA, VA & DC
b.good	13	CT, MA & ME
American Roadside Burgers	5	NY, SC & NC
Kraze Burgers	5	MD, DC & VA

Source: T&H research

## ARTISAN PIZZA CONCEPTS

Pizza chains represent another segment that attracted the significant interest from investors in 2013, and is expected to grow at an increasing rate through 2014. Fast-casual pizza chains are considered one of the hottest niches in the Restaurant Industry, and are attracting unique and varied sources of financing, including single operators. The most notable characteristic of pizza-chain investments in 2013 was not just the volume, but the variety of investors taking stakes to fuel growth in the segment.

The following chart highlights notable pizza concept investments in 2013:

<u>Investor</u>	<u>Concept</u>	<u>Transaction Details</u>
Lee Equity Partners		Undisclosed growth investment in a 6-unit fast casual pizza chain based in Carlsbad, CA.
Oak Equity Partners		Minority investment in a 18-unit custom pizza franchise with locations throughout the Southeast.
Chipotle Mexican Grille		Denver based full-service contemporary pizza concept developed in partnership with Chipotle Mexican Grille.
Private Investor		\$7 million minority equity investment from a private investor.
Buffalo Wild Wings		3-Unit 'Craft Your Own' fast casual pizza chain based in Los Angeles.
Private Investment Group		\$3 million investment from a private investment group for the 15-unit chain.
Consumer Capital Partners		Fast-casual pizza concept based in Denver, CO developed with seed financing from Consumer Capital Partners.

Source: T&H research

National chains also played a significant investment role and are seeking ways to capitalize on the hottest segment within the \$40 billion pizza market. Pizzeria Locale, a full service Denver based pizza chain with the financial backing and support from Chipotle founder Steve Ellis, is attempting to replicate Chipotle's signature customization and fresh ingredients and apply it to pizzerias. The national wing franchise Buffalo Wild Wings is also investing in the pizza space through the financing of a 'craft your own' style pizzeria based in Los Angeles.

The most unique source of financing in 2013 came in December when Los Angeles based 800 Degrees, which opened in January 2012, received a \$7 million equity investment from an unnamed investor.

## CONCLUSION

The influx of M&A and investment activity indicates that investors have fully recognized the growth potential in Fast Casual. Increased M&A activity and strong valuations are expected to prevail through the rest of 2014, fueled by continued investor demand for well-operated, growth-oriented restaurant concepts with superior unit level economics. In addition to the fast-casual concepts highlighted in this report, we also expect franchisees and multi-unit foodservice operators to benefit from the resurgence in restaurant industry investment.

This marks an exciting time for entrepreneurial restaurant operators. Differentiated restaurant concepts that capture emerging consumer preferences with scalable business models will be positioned to generate significant value moving forward. The influx in capital shifting into this industry will continue to drive favorable valuations for business owners through the rest of the year.

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## ABOUT TULLY & HOLLAND

### INVESTMENT BANKING SOLUTIONS FOR FOOD AND CONSUMER COMPANIES

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