Houlihan Lokey

Restaurants Industry Update

Q2 2024

Q2 From 30,000 Feet

Restaurants with clearly defined value propositions remain well-positioned for growth.

01

Wages have not kept up with inflation, inspiring greater price sensitivity among consumers and a difficult macro environment for restaurants that already operate on thin margins.

Optimistically, wages are projected to catch up with the rate of inflation by Q4 2024, leading discretionary income to recover, which should provide some support for operators going into 2025.

02

Greater price sensitivity today results in more discerning customers who allocate wallet share where they receive the most value.

However, notions of value are defined differently across restaurant categories, each representing a unique value proposition that appeals to its specific customer base (see page 3).

03

Same-store sales (SSS) trends reflect the bifurcation in performance across operators. With limited ability for restaurant operators to take incremental price, those operators that provide differentiated value benefit from flat or increased traffic, whereas the broader sector continues to experience traffic declines.

04

The restaurant industry is projected to grow approximately 4% in 2024. However, the number of locations opening continues to exceed the number of closed operations, making it difficult for operators to maintain market share and/or distinguish themselves.

In Q2, some operators were edged out of the market, evidenced by a wave of bankruptcies, largely due to expensive lease agreements, overleveraging, and lofty corporate overhead structures.

05

From an M&A perspective, transactions concentrated around a mix of premium, high-value assets and opportunistic acquisitions of underperforming brands, with an emphasis on new capital sources, such as family offices and strategic platforms.

Sources: Restaurant Business, Wall Street Research.

Defining "Value"

Value can be derived from various factors beyond price, including quality, relevance, convenience, and experience—the combination of which varies by restaurant category.

CATEGORICAL DEFINITION OF "VALUE"

Prevailing QSR concepts concentrate their operations/efforts on **speed of service**, **consistency**, and **lower price points**.

VALUE IN THE MARKET

- Customers demonstrate a preference for discounts on familiar items with clear cost advantages, in addition to straightforward, preselected meal items.
- In Q2, McDonald's launched $5 meal deals, which helped recover some traffic following widespread critique of elevated pricing.
- Domino's continues to leverage unique discounts to boost sales, namely through socially conscious promotions (e.g., discounts for student loan holders, "tips" to customers who tip delivery, etc.).
- Taco Bell managed to increase SSS by approximately 5% in Q2, having doubled its total menu items and limited-time offers (LTOs) since 2023; it also endorsed AI solutions to improve drive-through speed/accuracy.
- In 1H 2024, Raising Cane's, known for its fast, simple meals, increased SSS by approximately 18% and held AUV of approximately 2.3x the QSR mean.

CATEGORICAL DEFINITION OF "VALUE"

Leading fast-casual concepts deliver **high-quality**, **customizable food, pleasant meal settings**, and premium meal features for a **small increase in price**.

VALUE IN THE MARKET

- A powerful example of relative pricing power, CAVA increased prices by approximately 12% between 2019 and 2023 compared with the CPI's approximately 18% increase; QSR more broadly raised prices by approximately 31% over the same period, meaningfully impacting consumers' perception of value.
- CAVA's SSS improved by 14.4% in Q2, attributable to a 9.5% increase in traffic fueled by the launch of premium, reasonably priced menu items (e.g., steak), thus absorbing customers trading up from QSR and down from casual dining.
- Chipotle, a strong comp to CAVA in terms of food quality, nutritional value, and portions, also saw traffic increase 8.7% in Q2, following the return of its Chicken al Pastor. The company further announced the return of its Smoked Brisket as a fall LTO, cognizant of consumers' desire for premium menu items.

CATEGORICAL DEFINITION OF "VALUE"

Successful casual dining operators lean into their inherent virtues as **experiential/atmospheric** and place emphasis on **quality of service**.

VALUE IN THE MARKET

- Some casual dining operators have managed to drive growth by either limiting or opting out of third-party delivery services entirely (e.g., Pinstripes, etc.), playing into consumers' desire for authentic, in-person dining experiences instead of quick, transactional meal deals.
- Consumers thereby indicate resilience against the elevated costs of selected casual dining operators that confer the most unique and service-oriented experiences.
- Outback Steakhouse invested in new grills and handheld ordering tablets, which improved steak accuracy and customer experience consistency by 5%, supporting relatively flat SSS in Q2.
- Bloomin' Brands plans to remodel approximately 65 restaurants across its four brands to improve in-house dining experiences.

Sources: QSR, Nation's Restaurant News, Restaurant Dive, Restaurant Business, Wall Street Research.

Since When Is Fast Food Expensive?
QSRs Become Perceived as "Luxury"

As the price gap between "fast food" and fast casual shrinks, QSR brands must employ distinctive discounting strategies to maintain their reputation as the premier affordable meal option in an effort to prevent further traffic declines.

	Quick Service Restaurants (QSRs)	**Fast Casual**	**Casual Dining**
Q2 2024 SSS	2.5%	2.8%	1.4%
Traffic[(1)]	(2.1%)	(1.5%)	(3.9%)
2019–2024 Price Increase	~31%	NA	~26%
Value Thesis	Speed, Consistency, Affordability	High-Quality, Healthy, Customizable	Experience, Atmosphere, Service
Perceived Affordability[(2)]	~22%	~21%	~20%

Sources: Restaurant Business, SEC filings, Wall Street Research.
(1) Reflects YoY change as of June 2024.
(2) Reflects the reported percentage of customers who perceive the category as affordable.

Overview

- Approximately 80% of Americans, particularly lower-income consumers, now perceive fast food as a luxury, with grocery becoming the preferred option for inexpensive meal purchases; approximately 60% of consumers express that they now cook at home more often, motivated by lower levels of food-at-home (FAH) inflation.
- In 1H 2024, 65% of consumers expressed shock at QSR meal prices, although nearly 75% still visited once per week, albeit less than in 2019 when about one in three Americans consumed fast food daily.
- To address declining traffic, QSR brands have launched aggressive discounting/promotional campaigns aimed at restoring consumer confidence and improving positive sentiment (e.g., Mcdonald's $5 meal, KFC's $20 family meal, Taco Bell's $7 Luxe Cravings Box, etc.).
- Mobile ordering also remains a core focus for QSR brands as they seek to boost sales. Of note, 46% of consumers choose fast-food apps that they find enticing and that offer compelling digital promotions (e.g., "BOGO" deals, coupons, loyalty and rewards programs, etc.).
  – Across QSR brands, the in-app user experience may be equally or maybe even more important than in-person experiences, with the added benefit of obtaining first-party data.

Crowning Q2 Winners…
and Underperformers in Certain Categories

Category Exemplars

	Wingstop	CAVA	Texas Roadhouse
	QSR	Fast Casual	Casual Dining
SSS	28.7%	14.4%	9.3%
AUV[(1)]	~$2.0M	~$2.7M	~$8.0M
Traffic[(2)]	27.0%[(3)]	9.5%	4.5%
2023–2024 Price Increase[(2)]	NA	4.9%	2.2%
Value Thesis	Fast, Shareable Meals, Differentiated Concept	Premium Food, Healthy Options, Affordable Price	Big Portions, Quality Service, Family Atmosphere
Commentary	• Hyper-personalized digital sales experiences enable greater convenience. • Shareable menu, unique discounts, and signature items build a defensible moat.	• Consistently maintained pricing power, motivating trade-up from QSR/trade-down from casual dining. • Healthy, high-quality food options (including the addition of steak), boost appeal.	• Focused on enhancing food quality, consistency, and service. • Implemented strategic menu pricing and incremental improvements in labor productivity.

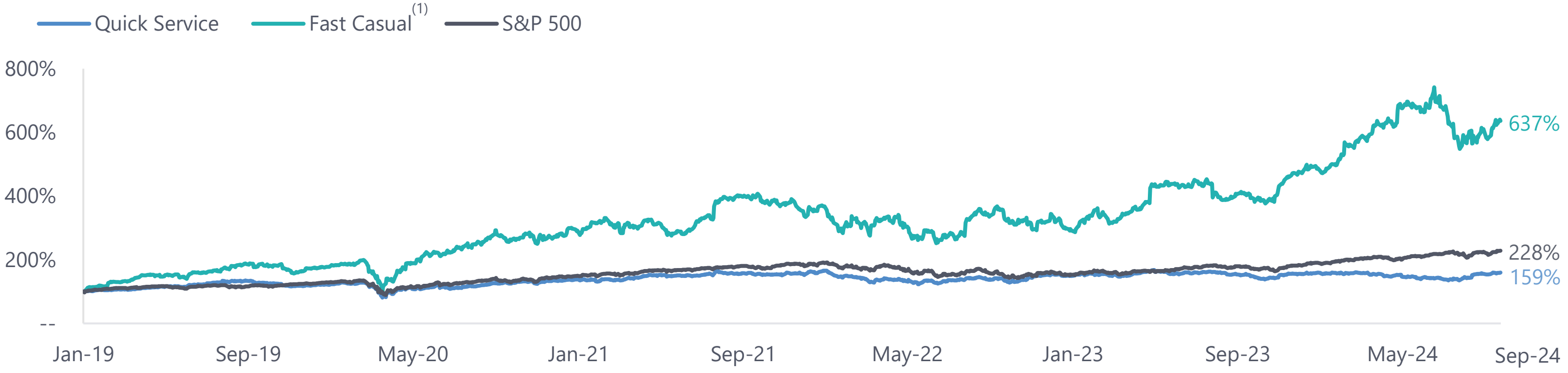
Bifurcation Within Pizza, Burger, and Mexican

	Domino's	Pizza Hut	Wendy's	Jack in the box	Taco Bell	Del Taco
SSS	4.8%[(4)]	(1.0%)[(4)]	0.6%[(4)]	(2.2%)	~5.0%	(3.9%)
Value Score[(5)]	22%	18%	30%	20%	33%	NA
Commentary	Domino's "Hungry for MORE" campaign boosted Q2 sales through refreshed marketing efforts, differentiated value offers, and general service enhancements, outperforming Pizza Hut, whose discounts failed to meet customers' expectations in the same way.		Wendy's ran various campaigns to promote traffic all day long, ranging from its $3 breakfast to its ever-popular "Biggie Bag," which topped the value rankings compared with other promotions. In contrast, Jack in the Box's snack-focused $4 Munchies Menu struggled to gain traction.		Taco Bell reigns supreme on value, beating out competitors like Del Taco, in addition to other QSR brands, through new, innovative menu items (e.g., Cantina Chicken, etc.), consistent LTO iteration, and technology investments that improve customer experience/efficiency.	

Sources: QSR, Restaurant Business, SEC filings, Wall Street Research.
(1) Reflects LTM June 2024 AUV.
(2) Reflects YoY change attributable to fast casual SSS and casual dining systemwide sales.
(3) Reflects the change in traffic levels between May 2024 and Aug 2023, as reported by Placer.ai.
(4) Reflects U.S. locations only.
(5) Reflects the percentage of customers that perceive brands as providing "good value" (e.g., reasonably priced deals, loyalty and other digital offers, etc.).

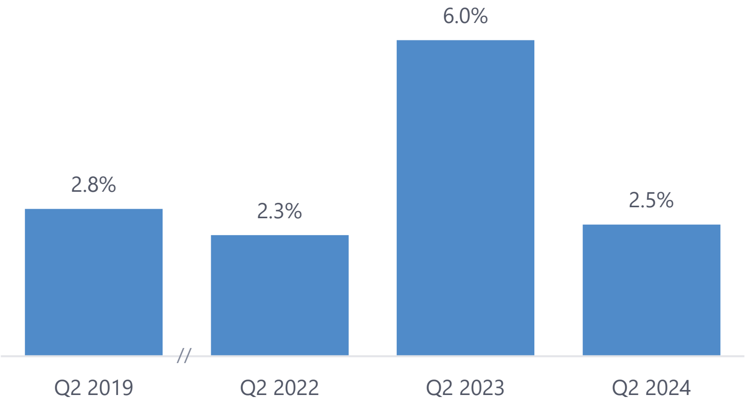
Limited-Service Operator (LSO) Update

Public Market Performance

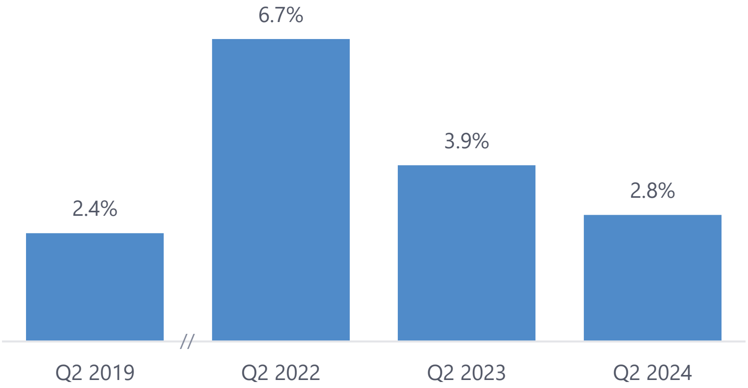


Recent Same-Store Sales Trends: LSOs(2)

Quick Service Restaurants (QSR)



Fast Casual



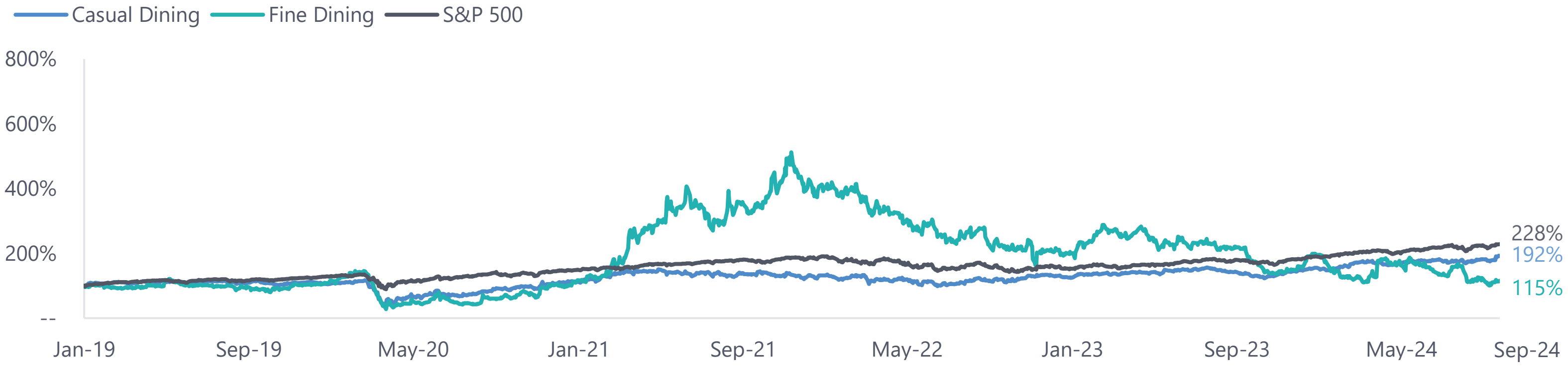
Sources: Restaurant Business, Wall Street Research.
Note: Companies included in each category have been trading from January 1, 2019, through September 24, 2024.
Pricing as of September 24, 2024.
(1) Fast casual index led by strong performance from Chipotle (+654%) and Wingstop (+693%).
(2) Summarizes SSS performance as an equal-weighted average of the foremost public brands in each respective category.

Industry Trends

- While price continues to pressure consumer spending, LSO inflation moderated slightly in Q2, stabilizing at approximately 4.3% through June (vs. 4.5% in May); FAH inflation, however, resided meaningfully below LSO, at approximately 1.1%, encouraging budget-conscious consumers to elect grocery alternatives with greater frequency.
- Beyond food away from home (FAFH) vs. FAH dynamics, inflation has also reshaped competition within the LSO segment as more consumers gravitate toward fast casual, drawn by inherently higher-quality menu offers compared with QSR, where historical cost advantages have diminished following significant price hikes (up approximately 31% since 2019).
  - Fast casual experienced milder traffic declines in June vs. other categories, down just 1.5% YoY (vs. QSR, down 2.1%), absorbing customers trading up from QSR and down from casual dining.
- In response to ongoing traffic struggles, leading QSR operators have reinforced core strengths of affordability (e.g., discounts) and speed (e.g., AI adoption) while emphasizing menu innovation; since 2022, total QSR LTOs and new menu items increased by 112%.
- After a successful first round of adoption by selected players, experts anticipate industry-wide implementation of various technologies within approximately 12–18 months; these technologies should enhance sales/service efficiency, particularly across LSOs, and will become necessary to remain competitive.
  - Though not an LSO, IHOP’s new AI recommendation engine increased average check size by 10% and led 73% of customers to buy suggested items. CAVA further plans to use AI video tech to improve ingredient use, while Taco Bell’s AI voice drive-through technology boosted sales by 10% and reduced wait times by about 10 seconds.
  - The next phase will likely explore how restaurant conglomerates (e.g., Dine Brands, etc.) can integrate new programs across various brands to maximize customer retention.

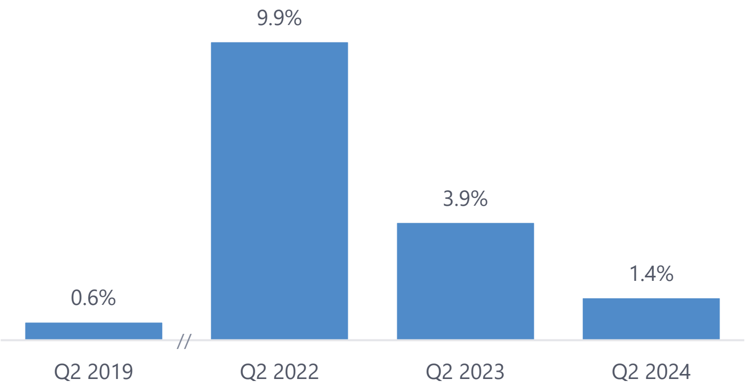
Full-Service Operator (FSO) Update

Public Market Performance

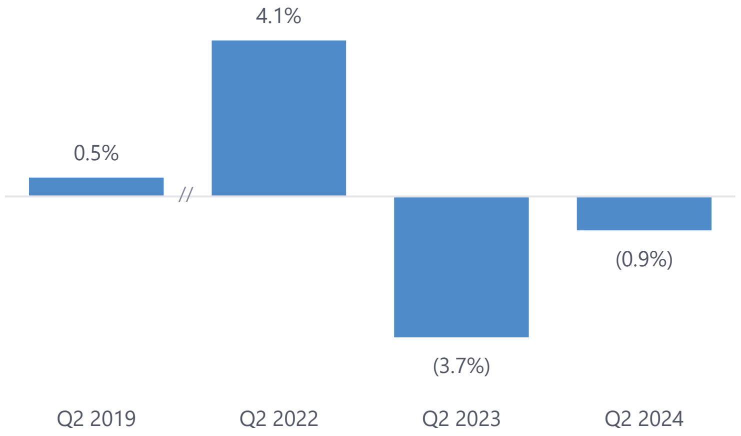


Recent Same-Store Sales Trends: FSOs

Casual Dining



Fine Dining



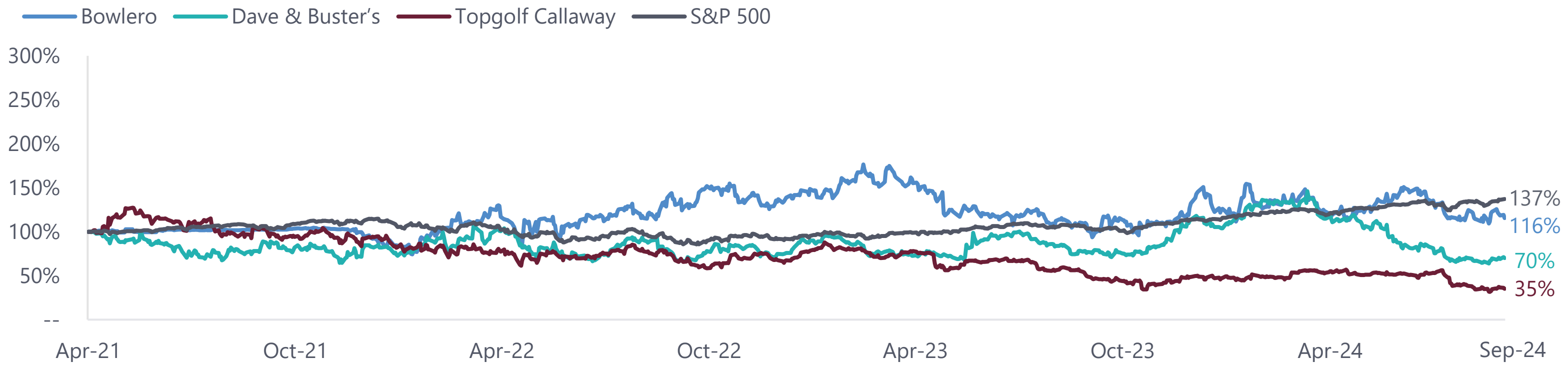
Sources: Restaurant Business, Wall Street Research.
Note: Companies included in each category have been trading from January 1, 2019, through September 24, 2024.
Pricing as of September 24, 2024.

Industry Trends

- In Q2 2024, elevated price levels characteristic of FSOs made the category inherently more vulnerable to pressures felt industry-wide; while casual dining managed to increase SSS by approximately 1.4%, fine dining operators were less successful, with SSS dropping 0.9%.
  - Traffic levels, however, suggest that casual dining remains largely suspended by price, given that traffic levels fell 1.4% in May and 3.9% in June; fine dining volume declines, on the other hand, stayed mostly in line with SSS performance, falling 0.4% in May and 0.5% in June.
- Certain casual dining operators (e.g., Texas Roadhouse, Brinker, etc.) excelled in Q2 without overleveraging price by embracing shifting consumer preferences, playing into their category's definition of value to deliver strong performance results. As consumers become more budget-conscious and the cost gap between delivery and in-person dining narrows, it becomes increasingly evident that consumers are willing to pay slightly more for options that maximize convenience or enhance the dining experience while showing less interest in mid-range offerings (e.g., drive-thru).
- These dynamics underscore a broader industry trend (and implicit opportunity for FSOs) whereby operators must concentrate their efforts on the poles of the value spectrum to stand out, whether by offering uniquely convenient vs. memorable experiences or discounted vs. premium meal options.
  - Kura Sushi, Gen Korean BBQ, and Blue Sushi Sake Grill all achieved double-digit SSS growth in 2023 by leaning into experiential/shareable meal aspects that resonate with consumers.
- The need for concept differentiation and heightened levels of competition comes as a result of waning market share and unprecedented levels of new entrants/incumbents.

Eatertainment Update

Public Market Performance



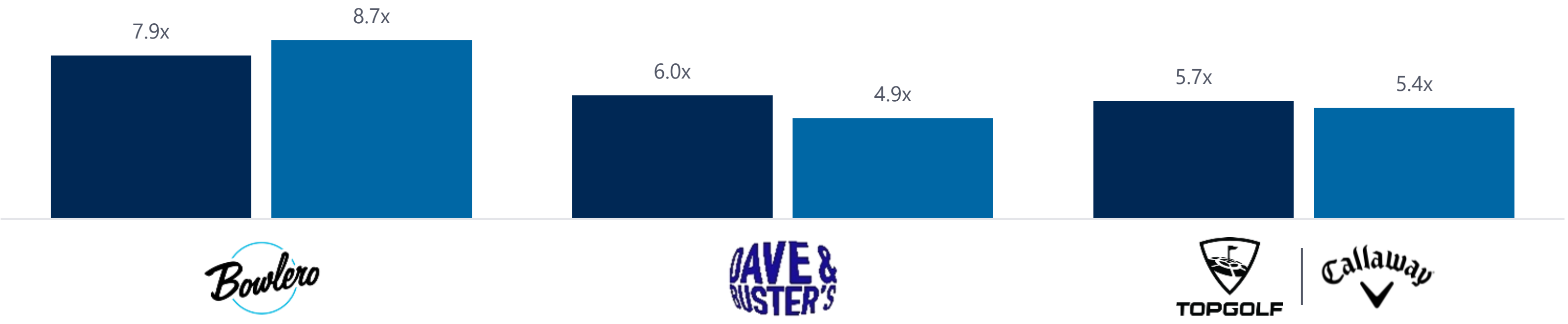
Eatertainment Trading Multiples

Jan-24 Mean: 6.6x

Sep-24 Mean: 6.3x

Jan-24 Sep-24

YTD, there has been mixed eatertainment performance in the face of traffic challenges and limited ability to increase price; historically, however, the industry has weathered short-term macro headwinds well, limiting down cycles in duration relative to the broader market.



Sources: Roller, Placer.ai, SEC filings, Wall Street Research.
Note: Companies included in each category have been trading from April 23, 2021, through September 24, 2024.
Pricing as of September 24, 2024.

Industry Trends

- By synthesizing high-value food and beverage offers with an engaging set of activities (e.g., bowling, arcade rooms, billiards, etc.), eatertainment concepts present highly compelling value propositions that connect with various age demographics.
  - 78% of millennials expressed a preference for eatertainment over other consumer products, while 70% of all consumers indicated favor for eatertainment over casual dining, revealing a meaningful diversion of spending activity toward eatertainment.
- While trade-down behavior and value-consciousness benefited eatertainment in Q1, widespread traffic declines (down 2.8% in June) have been more impactful on eatertainment concepts, double penalized on synergies between on-premise dining and entertainment sales.
- Still, eatertainment continues to attract consumers across the full convenience-to-experience spectrum, offering a more convenient (and often more affordable) alternative to regional entertainment (e.g., concerts, theme parks) while delivering a far more experiential option than traditional restaurant categories.
  - Dave & Buster's and Main Event bring in approximately 77% and 83% of their customers, respectively, from within 30 miles, highlighting the appeal of local entertainment.
  - While both operators face challenges with walk-in visitation, Dave & Buster's demonstrated an understanding of consumers' want for shared experiences as reflected in a 9% increase in special events program revenue compared with 2019.
- While traffic remains a reasonable concern, the diversification of entertainment's revenue base (which supports higher average check sizes), ongoing consumer support, and the industry's inherent cyclicity inspire optimism.
- As wages/discretionary income recover through the end of 2024, the category should see meaningful uplift and momentum going into 2025.

Selected Recent M&A Transactions

The restaurant M&A market has slowed, but high-value deals and opportunistic acquisitions, fueled by new capital sources, show resilience and hint at recovery despite economic challenges.

Transaction		Date[(1)]	Strategic Rationale	
Playa Bowls	Sycamore Partners	Sep-24	Fuel rapid expansion both domestically and internationally with the help of Sycamore's multi-unit/retail brand experience.	LEARN MORE
Rubio's Coastal Grill	TREW Capital Management	Aug-24	Declared bankruptcy in June and sold the business to the existing lender, TREW Capital Management, in an uncontested bid.	LEARN MORE
Insomnia Cookies	Verlinvest / Mistral Equity Partners	Jul-24	Accelerate growth path to reach more than 1,800 bakeries in the U.S. and abroad, following the success of a Krispy Kreme partnership and elevated demand levels.	LEARN MORE
Red Lobster	Fortress	Jul-24	Acquired by the existing lender Fortress Investment Group after filing for Chapter 11 in May. Secured $60 million of additional funding and implemented a new CEO.	LEARN MORE
Chuy's	Darden	Jul-24	Acquired all outstanding shares on the premise of asset alignment and interest in diversifying Darden's existing portfolio into a new dining category.	LEARN MORE
MOD Pizza	Elite Restaurant Group	Jul-24	Assumed 100% equity stake via a merger agreement between the company and an Elite affiliate to prevent bankruptcy after meaningful store closures.	LEARN MORE
Carrols	rbi restaurant brands international	May-24[(2)]	Acquired all outstanding shares of Carrols Restaurant Group, the largest U.S. Burger King franchisee, with the goal of accelerating renovations across more than 600 restaurants.	LEARN MORE
Tropical Smoothie Cafe	Blackstone	Apr-24	Intended to help accelerate the company's already rapid growth via sustained investment in menu innovation and marketing.	LEARN MORE

Sources: Nation's Restaurant News, Reuters, Restaurant Business, Wall Street Research.
(1) Reflects announcement date, unless otherwise denoted.
(2) Closed May 2024.

Restaurant Industry Market Map

Limited-Service Restaurants

Quick-Service Restaurants

~2B+

McDonald's, Domino's Pizza, Jack in the box, Starbucks, Little Caesars, Sonic, Chick-fil-A, Papa John's, Panera Bread, Taco Bell, Panda Express, Pizza Hut, Wendy's, Whataburger, KFC, Dunkin', Raising Cane's, Popeyes, Burger King, Jimmy John's, DQ, Subway, Jersey Mike's Subs, Arby's

~$250M+

Culver's, Hardee's, Bojangles, Carl's Jr., Firehouse Subs, Krispy Kreme, Auntie Anne's, Checkers, Rally's, Tropical Smoothie Cafe, Marco's Pizza, Del Taco, El Pollo Loco, McAlister's Deli, Charleys, Steak 'n Shake, Tim Hortons, Baskin Robbins, Church's, Smoothie King, Jason's deli, Portillo's, White Castle, Jamba, Hungry Howie's, Dutch Bros

~$50M+

Jet's Pizza, Taco John's, Cold Stone, Corner Bakery, Peet's Coffee & Tea, Caribou Coffee, Krystal, Wienerschnitzel, Long John Silver's, Donatos, Wetzel's Pretzels, Cinnabon, Biggby Coffee, Cook Out, Rita's, Sbarro, Sarku Japan, au bon pain, Daylight Donuts, Great American Cookies, Yogurtland, Pret, Pei Wei Asian Kitchen

Fast Casual

~$250M+

Five Guys, Chipotle Mexican Grill, Zaxby's, Wingstop, Qdoba Mexican Eats, Papa Murphy's, Shake Shack, MOD, Freddy's Steakburgers, Noodles & Company, The Habit Burger Grill, Potbelly Sandwich Shop, Dickey's Barbecue Pit, Boston Market, Moe's Southwest Grill, Blaze Pizza, Godfather's Pizza, Schlotzsky's, Cafe Rio, Mountain Mike's Pizza, Smashburger

~$100M+

Golden Chick, Fazoli's, Slim Chicken's, Taco Cabana, Pollo Tropical, sweetgreen, Newk's, Zoës Kitchen, Pizza Pro, Fuzzy's Taco Shop, BurgerFi, Hwy 55, Pollo Campero, L&L Hawaiian Barbecue, CAVA, Taco Bueno, Mission BBQ, Runza, Farmer Boys, Jimmy's, Pieology, Torchy's Tacos, Wayback Burgers, Peter Piper Pizza, Tijuana Flats, Fish Grill, Nathan's, Skyline Chili, Freebirds, Imo's Pizza, Lee's Famous Recipe Chicken, Church's, Mazzio's

~$50M+

Capriotti's, Ono Hawaiian BBQ, Teriyaki Madness, Bush's Chicken, Baja Fresh, Dion's, Pizza Patrón, Taco Casa, Pollo, Rosati's, Tazikis Mediterranean Cafe, Dog Haus, Nando's, bb.q Chicken, Giovanni's Pizza Power, Rudy's Real Texas Bar-B-Q

Full-Service Restaurants

Quick-Service Restaurants

~$500M+

Olive Garden, Chili's, The Cheesecake Factory, LongHorn Steakhouse, Waffle House, Golden Corral, Red Robin, BJ's, Outback Steakhouse, Red Lobster, Applebee's, Buffalo Wild Wings, IHOP, Texas Roadhouse, Denny's, Cracker Barrel, P.F. Chang's, TGI Fridays, Carrabba's Italian Grill, Hooters, Bob Evans, Cheddar's Scratch Kitchen, Bonefish Grill, Yard House

~$250M+

Captain D's, First Watch, California Pizza Kitchen, Perkins, Jefferson's, Ruby Tuesday, Cooper's Hawk, Fogo de Chão, Chuy's, Twin Peaks, Miller's Ale House, Mellow Mushroom, Saltgrass Steak House, O'Charley's, Famous Dave's, Black Bear Diner, Benihana, Ninety Nine, Braum's, Village Inn, On The Border, Logan's Roadhouse, Bahama Breeze, Friendly's

~$100M+

Rosati's, Texas de Brazil, Huddle House, Jack's, Hard Rock Cafe, Old Chicago Pizza + Taproom, Sonny's BBQ, Bar Louie, Firebirds, 54th Street, Walk-On's, Lazy Dog, Pappadeaux, Uno, Beef 'O' Brady's, LaRosa's, Smokey Bones, Roosters, Bar Louie, Sizzler, North Italia, Eddie V's Prime Seafood, Friendly's

Fine Dining

~$250M+

Fleming's Prime Steakhouse & Wine Bar, Ruth's Chris Steak House, The Capital Grille, Mastro's Restaurants

~$100M+

Maggiano's Little Italy, Seasons 52 Fresh Grill | Wine Bar, Morton's The Steakhouse

~$50M+

M&S McCormick & Schmick's est. 1974, Chart House, Flanigan's

Eatertainment[1]

cicis pizza, Pizza Ranch, Tinsel Social, Chuck E. Cheese, Mr Gatti's Pizza, Dave & Buster's, Funlab!, Drive Shack, Puttery, Topgolf, Andretti Indoor Karting & Games, Round1 Bowling & Amusement, Punch Bowl Social, Bowlero, Puttshack, Main Event, Swingers, K1 Speed, Pinstripes Bistro Bowling Bocce, Round Table Pizza, PopStroke Eat. Putt. Drink., Ten, Chicken N Pickle

(1) Given a more limited pool of existing operators, the eatertainment category confronts significant whitespace opportunity.

Houlihan Lokey Restaurant Coverage

Houlihan Lokey has comprehensive global coverage and specialized resources dedicated to the restaurant sector.

Investment Banking

We have a track record of structuring and executing value-optimizing transactions for our clients.

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Our team has an extensive and expansive reach of the highest-likelihood debt and equity investors within the restaurant sector globally.

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We advise clients on strategic alternatives that enable them to accomplish next-level strategic goals—whether the aim is accelerated growth or partial or full sale.

We are uniquely positioned to help address special situations, ranging from liquidity management to recapitalizations.

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2023 M&A Advisory Rankings
All Global Transactions

	Advisor	Deals
1	**Houlihan Lokey**	**352**
2	Rothschild & Co	349
3	Goldman Sachs & Co	300
3	JP Morgan	300
5	Morgan Stanley	253

Source: LSEG (formerly Refinitiv).
Excludes accounting firms and brokers.

No. 1
Global M&A Advisor

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Capital Markets Advisor

FINANCIAL RESTRUCTURING

2023 Global Distressed Debt &
Bankruptcy Restructuring Rankings

	Advisor	Deals
1	**Houlihan Lokey**	**73**
2	PJT Partners Inc	64
3	Rothschild & Co	51
4	Lazard	37
5	Evercore Partners	27

Source: LSEG (formerly Refinitiv).

No. 1
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Transactions Completed Valued at More Than $3.5 Trillion Collectively

FINANCIAL AND VALUATION ADVISORY

1999–2023 Global M&A
Fairness Advisory Rankings

	Advisor	Deals
1	**Houlihan Lokey**	**1,247**
2	JP Morgan	1,035
3	Duff & Phelps, A Kroll Business	977
4	UBS	884
5	Morgan Stanley	716

Source: LSEG (formerly Refinitiv).
Announced or completed transactions.

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