UNBRIDLED CAPITAL
FRANCHISE INVESTMENT BANKING

Title: Welcome to The Restaurant Boiler Room Episode 11. I'm your host, Rick Ormsby, Managing Director at Unbridled Capital.

Today, in the the Boiler Room:

1. January restaurant comps post a strong +2%, but traffic declines persist
2. Unbridled provides sell-side advisory to 82-unit Pizza Hut franchisee
3. Highlights from the Annual KFC Convention in Orlando

Tag Line: The Restaurant Boiler Room is a one-stop-shop for multi-million dollar merger and acquisition activity and financial complexities affecting the franchise restaurant industry. We talk money, deals, valuations and risk – delivered to the front door of franchisees, private equity firms, family offices, large investors and franchisors on an every-other-week basis. Feel free to find our content at Unbridled Capital's website at www.unbridledcapital.com

Now, let's enter the Boiler Room:

A. January restaurant comps post a strong +2%, but traffic declines persist

   a. Background: TDn2K recently reported January sales comps of 1.96% with a Rolling 3-month trend of 1.68%. Traffic comps were down by (0.72%) and (1.12%), respectively.

   b. Comments: This is the second consecutive month that comp sales have been at 2%, signaling the best two months of sales growth in the industry in over two years. The report indicates that 73% of DMAs nationally had positive sales growth. The Southeast was the strongest, while the Midwest was the weakest, likely due to bad January weather in the Midwest area.

   c. Some of the highlights from the TDn2K release:
      i. New store openings continue to hurt same-store traffic – *this is certainly true*.
      ii. Consumer spending expected to continue expanding at a moderate pace – *I agree with this as well, barring any unforeseen geopolitical or economic headwinds in the near term*.
      iii. Sales were strong throughout the entire industry in January
      iv. Weather was a factor in January – *no doubt the historically-frigid spell in the Midwest, as well as unexpected snow on the East Coast – hurt sales in January*.
      v. Staffing challenges continue for restaurants – *this, combined with wage increases, is the single-biggest issue in the retail industry right now.*

   d. Effect on M&A: Overall, I think these sales increases are great news for the restaurant industry. Unbridled is involved in several assignments currently across 7-8 brands, and most appear to be doing well from a sales perspective as we start the year as well. If increased revenues do not come with margin compression, a positive sales environment normally bodes very well for a strong year of M&A. Everyone should choose to sell their business when things are going well and moving upward. Only the unwise operator will consider selling only when things aren't going well.

e. A substantial portion of the sales growth seen recently is due to continued pricing increases taken to combat minimum wage. Most states that have enacted minimum wage increases do so at the first of the year. These pricing increases are showing up in the persistently negative traffic comps we continue to see each month. As I have said before, the best brands have pricing power and are able to raise prices above the labor increases – delivering stronger EBITDA. For other brands without pricing power – most notably West-Coast centered-brands and pizza brands - pricing increases are dramatically affecting traffic. It is a bad situation.

B. Unbridled provides sell-side advisory to 82-unit Pizza Hut franchisee

a. *Background*: Unbridled Capital recently provided sell-side advisory to High Plains Pizza on the sale of 82 Pizza Hut restaurants in MT, WY, UT, CO, KS, OK and TX. The restaurants were sold to existing franchisee Grand Mere Capital, led by Mike Cherney, who is a good friend of mine.

b. In 1962, Bill Colvin decided to leave the oil industry and venture out into franchising with the Pizza Hut Brand. Bill and then partner Norman Blankenship opened their first location in Liberal, Kansas in 1962, and after their partnership split, Bill and his family grew to own and operate Pizza Hut restaurants throughout the country. Their focus was on quality, service and giving back to their communities. Not surprisingly, High Plains Pizza became known for its brand leadership and for having some of the best and highest volume dine-in restaurants in the entire Pizza Hut system. Bill had four sons who became involved in the business: Kent, Mike, Tracy and Greg. Kent became President of High Plains Pizza and shepherded its growth and vision. Kent's imprint on the Pizza Hut brand will continue to be seen for many years to come.

c. Effect on M&A: This closing marks a long list of Pizza Hut transactions completed by Unbridled over the past few years, including the following: 17 in AL, 25 in KS/MO, 10 in KS/MO/NE, 43 in WI, 17 in IA, 39 in KS/CO, 43 in IN and now 82 in the Western US. We also have over 200 Pizza Huts currently for sale across the country, and we project at least another 100-200 nationally by mid-year 2019.

d. As I have discussed in previous podcasts, the Pizza Hut community is undergoing a major demographic shift as many legacy franchisees are retiring, passing away or selling their businesses – all while the brand is trying to turn itself around.

e. The Pizza Hut franchise base is very large in average unit count – over 50 units per franchisee, on average. These acquisition opportunities are therefore creating a great way for new family offices and private equity companies to make a platform acquisition into new brand with a high unit count, healthy G&A to hire professional operators, and the ability to expand through acquisition. For the High Plains acquisition, Mike Cherney and Grand Mere Capital have grown to about 150 Pizza Huts over the past 18 months. They have great operations, fresh ideas, a new seat on the Pizza Hut board and are likely to be a considerable force in helping to change the culture and future of the Pizza Hut brand.

f. Opportunities are high for further M&A consolidation this year, and while Pizza Hut EBITDA multiples are not low (typically in the 5.5-6.0X range), the brand offers a relative value play when compared to many other brands if the would-be buyer has an optimistic view on the brand turnaround and asset strategy over time.

g. Testimonial Kent Colvin: “I have known and trusted Rick Ormsby for many years. When we came to the decision to sell our 56-year-old family business, there was no hesitation in turning to Unbridled Capital to represent High Plains Pizza. Unbridled played an instrumental role in helping us through this transition. We appreciate their relationships with buyers, their analytical expertise, their integrity, their persistency and their friendship. We would highly recommend Unbridled Capital to anyone looking to sell or finance their business,” said Kent Colvin.

h. Thank you so much for the kind words, Kent! And as a condition of this closing, Unbridled Capital has made charitable contribution to the Pizza Hut museum at Wichita State University. We want to show our respects to the fantastic legacy of the Pizza Hut brand. We want to be a blessing because we’ve been blessed. Giving back to the brands in which we do business is a cornerstone of our company.

C. Highlights from the Annual KFC Convention in Orlando

a. Background and Comments: KFC just completed its annual Convention in Orlando from Feb 6-10, 2019. I have been attending KFC Conventions since 2006 after I left KFC Corporate’s finance department in Louisville. This Convention certainly felt different than many ones in the past. Here are some items of note:

i. The brand has had 4 straight years of positive same store sales growth, and you could tell it from the buzz around the Convention. Franchisees, Corporate employees, partners and vendors were remarkably uplifting about the brand and its future direction.

ii. Kevin Hochman and his team have done a great job in the new product innovation area, and I think it will really resonate well with consumers in 2019. At the time of the Convention, KFC was on promotion with Chicken and Waffles, and other than product availability issues, almost everyone in Orlando was happy with the sales lift and mix of the product and promotion. KFC is going to be partnering soon with Cheetos to offer a Cheetos Chicken Sandwich. This might sound gimmicky to some, but I have watched the success at Taco Bell with their branded Doritos Locos Taco promotions and their Fruitista Freezes. Those new products were not only successful initially, but they allowed Taco Bell to launch subsequent line-extension promotions over several years, which helped Taco Bell to build a fortress-like product innovation platform that crushes every other restaurant brand. It is no surprise that KFC is thinking the same way, and with several other very interesting products on-tap for the future, expect a longer-term Taco Bell-like product innovation strategy at KFC as well. I don’t think it will be as immediately successful as it was at Taco Bell – the customer base at KFC is different – but a slow and steady incremental sales layer from new products will be a great way to grow the KFC brand if successful.

iii. The number of lenders at the KFC Convention has likely quadrupled over the past two years. I saw at least 5 new lenders at this year’s Convention. Many of them have absolutely no idea about the brand – some of the lenders have probably never eaten at a KFC. Nonetheless, the influx of capital at KFC is very welcome and reminds me of Taco Bell in

2012. Now, any lender will fall on a sword to finance a Taco Bell deal. Let's hope the unprecedented lender attendance at the KFC Convention will continue to open doors for the KFC franchisees looking to expand their businesses.

iv. The average age and number of franchisees are both dropping precipitously. Colonel Sanders started KFC by finding small, mom-and-pop operators as franchisees, and that legacy continued for decades in the brand. Annual conventions were thus largely filled with small franchisees over the years, many of them first generation. These franchisees have recently sold their businesses at a higher pace than normal – we all know the pressures on the franchise industry are chewing away at the financial health of smaller operators. KBP Foods has been on a buying spree over the past few years as their size within the KFC system has swelled to over 700 units and growing. The brand is basically begging for new franchisees to enter the system – well capitalized groups such as the ones entering brands like Pizza Hut, Burger King, Taco Bell and Wendy's. Overall, the convention felt much, much younger and smaller – a trend that will continue as dozens of smaller and older KFC franchisees are projected to sell their businesses in the coming years.

v. Like all major brands, there was quite a bit of discussion about how to combat rising minimum wage throughout the country – through labor efficiencies, pricing initiatives and better scheduling. KFC was talking about new pre-packaged cookies and already buttered biscuits as possible ways to squeeze for marginal labor efficiencies. The $5 fill-up was a topic of continued conversation among the franchisees. The high mix and high cost of the chicken strip $5 fill-up was very worrisome for West Coast and Northeast franchisees who fear that their profit margins are in serious jeopardy at the $5 price point. Again, this conversation is very similar to what is happening at Taco Bell as well.

b. Effect on M&A: Unbridled has helped a bunch of franchisees sell their KFCs recently: 4 in KS, 6 in CA/AZ, 15 in OH/WV/PA, 15 in MI, 24 in OH/KY and 6 in OH/KY, for example. We also have 9 active KFC assignments currently with large, mid-sized and smaller KFC franchisees. We expect the consolidation trend in KFC to continue and accelerate over the next year or so. This should provide plenty of opportunities for buyers; however, due to the small average size of the typical KFC franchisee, there will always be a premium in the brand for the platform KFC franchise investments (that are 15 units or more) because of their relative infrequency and the attractiveness of an outside investment in the brand that could eventually buy-down its EBITDA multiple over time with acquisitions of smaller franchisees.

Closing: Thanks so much for entering the Boiler Room today. You can find our podcasts on iTunes, Google Play, Stitcher, TuneIn and Spotify. If you like these podcasts, please listen, rate and review! I also encourage you to visit our website at www.unbridledcapital.com for the best franchise M&A and financial resources in the industry. Our website includes podcasts, videos, white papers and a list of our M&A transactions.