Title: Welcome to The Restaurant Boiler Room Episode 2. I'm your host, Rick Ormsby, Managing Director at Unbridled Capital.

Today, in the the Boiler Room:

1. Restaurant Sales Are Up While Traffic Tries to Rebound
2. Franchisees Voice Concern About Capital Spending at McDonald's
3. Jack-in-the-Box Franchisees Want CEO Ousted
4. Question of the Week: How is the M&A Environment at Pizza Hut?

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. Restaurant Sales Are Up While Traffic Tries to Rebound
   a. *Background*: TDn2K reports that restaurant same-store-sales were up nicely in September for a 4th consecutive month at 1.2%. For Q3, same store sales were up 1.2%. Traffic was still down by (1.4%) and (1.3%), respectively.
   b. *Why it is important*: While negative, this was the best traffic quarter in the last three years – which is great news. For now, menu pricing is still winning the day as fewer customers are coming into restaurants than last year, particularly in the Southwest. Competition on value remains fierce with highly discounted prices within the pizza and burger segments as well as the proliferation of the $5 price point: $5 fill-up (KFC), $5 box (Taco Bell) and the $5 All-Star Meal (Hardee's), the later of which is likely a carry-over from Jason Marker, who left KFC about 18 months ago to take the job as CEO at CKE Restaurants.
   c. *How it will affect M&A*: Improving sales will usually result in improving EBITDA unless sales increases have high food and paper costs and if customers trade-over and buy value offerings instead of lower-cost items on the menu. Restaurant operations are valued as a multiple of EBITDA, and real estate is priced on implied rents, cap rates, rent coverage ratios and term of the remaining franchise agreement. While industry sales have been going up, looking at traffic is often a better predictor of EBITDA growth and increases in restaurant valuations over time.
   d. *Personal experience*: I'm pleased to see that traffic trends are improving, but it is a bit concerning to me that we have such strong GDP growth and low unemployment, yet restaurant traffic is still declining on a year-over-year basis despite heavy discounting. A closer look will show a dichotomy between brands that are really succeeding and brands that are really struggling with traffic growth. The winning brands execute the right playbook – great customer service, strong operations, innovative new products, upgraded assets and great leadership.

B. Franchisees Voice Concern About Capital Spending at McDonald's
   a. *Background*: CNBC reported that a group of McDonald's franchisees met recently in Tampa to discuss concerns in the brand. The report concludes that franchisees are voicing concerns about pouring money into updating stores, adding touch-screen kiosks and refrigerators needed to serve fresh beef burgers, but that the return on investment is low. Newly remodeled restaurants in the U.S. usually see a pick-up in sales in a mid-single-digit percentage in the first year. The addition of self-order kiosks can boost sales by 1 percent to 2 percent.
   b. *Why it is important*: McDonald's Q2 and Q3 same store sales growth was 2.6% and 2.4% in the US, respectively. On the surface, this sounds pretty strong when compared with the overall restaurant industry. However, capital spending and discounting have likely had an impact on franchisees' EBITDA and bank covenants this year.
   c. *How it will affect M&A*: Capital spending is crucial for a brand's overall success and longevity. Many brands would be happy with mid-single digit sales increases from remodels. However, McDonald's remodels are expensive when compared with other QSR brands. On the M&A front, buyers will discount valuations to account for future remodeling and capex spending, especially when it has a questionable pay-back. And for franchisees, borrowing more money affects their financial condition, keeping in mind that remodeling is oftentimes a defensive play needed to protect existing EBITDA.
   d. *Personal experience*: The focus on capital spending and new unit development are at all-time highs while the restaurant industry is contending with moderate sales growth, lower traffic, intensified competition and minimum wage pressures. Several franchise brands are using their franchise councils to put pressure on franchisors to elongate remodel dates or reduce the scope and cost of remodeling projects. Expect this trend to continue – this is a predictable if healthy push and pull between franchisors and franchisees.

C. Jack-in-the-Box Franchisees Want CEO Ousted
   a. *Background*: The Jack-in-the-Box Franchise Association has evidently voted 'no confidence' in CEO Lenny Comma and have asked for him to be replaced.
   b. *Why it is important*: Franchisees at Jack-in-the-Box are struggling financially due to several reasons – recent refranchising at high prices, disappointments in recent marketing initiatives and a high concentration of restaurants and franchisees on the West Coast.
   c. *How it will affect M&A*: Because of high minimum wage on the West Coast, many franchisees of many brands are struggling right now. There is no easy fix when there has been surprisingly low pricing power, even as labor costs are rising precipitously. Additionally, Jack has a complex franchisor-franchisee relationship that is structured differently than many other brands.
   d. *Personal Experience*: I am worried about the health of Jack-in-the-Box franchisees and the brand. This is primarily a West Coast brand, and I believe that minimum wage is one of the 2-3 biggest issues facing the restaurant industry. There are large, well-capitalized operators in the Jack system, and the brand needs their support and stability to get on the right track.

D. *Question of the Week*: How is the M&A Environment at Pizza Hut?
   a. *Background*: I just returned from the Pizza Hut Lender Day in Plano, TX. I was impressed by several new members of the leadership team. The brand has a focus on value, their digital platform, store level economics, assets, product innovation and the NFL Partnership. A

turnaround doesn't happen overnight – these foundations will hopefully provide the right stuff in creating a sustainable advantage for Pizza Hut over time.

b. *Why it is important*: Pizza Hut is undergoing a generational shift in the franchisee base. Pizza Hut is a unique brand in that 6,500 or so units are held by only about 100 franchisees. Many of these franchisees are original owners from the 1960's. They built a very successful business based heavily on dine-in pizza, but in recent years, the brand has started to migrate to delivery stores as customer preferences have shifted and Domino's has pioneered the increasing use of technology.
c. *How it will affect M&A*: There have been several large consolidators (both private equity firms and operators with family-office backing) that have entered the Pizza Hut system in the past two years. The M&A market in Pizza Hut has been very strong. In Unbridled's deals, EBITDA multiples paid for Pizza Hut businesses have risen by over 30% in the past 18 months. Recent multiple accretion is largely due to three factors – 1. Buyers believing that a turnaround is coming, 2. The attractiveness of the size of Pizza Hut acquisitions, enabling buyers to have significant G&A and 3. Yum's best-in-class reputation for franchisor support, long-term results and M&A liquidity in their brands.
d. *Personal Experience*: I think the Pizza Hut turnaround will take time. There are many positive initiatives, and the future of the business is certainly with delivery stores. Legacy franchisees will continue to sell their businesses, and the shift in asset type will take time. New and younger franchisees are already providing valuable perspectives that will help the brand avoid another strategy mistake in falling behind on digital ordering. I do believe in the brand's long-term success if it can leverage its reputation for innovation, expertise of its delivery driver network, improving digital platform and strong-capitalization of its franchise base.

Closing: Thanks so much for entering the Boiler Room today. You can find our podcasts on iTunes, Google Play, Stitcher 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.