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Title: Welcome to The Restaurant Boiler Room Episode 9. I'm your host, Rick Ormsby, Managing Director at Unbridled Capital.

Today, in the the Boiler Room:

1. Planet Fitness Brand Discussion, Valuation and Outlook
2. Brand Affinities for Gen Z Consumers
3. Skepticism of Third-Party Delivery Platforms
4. Question of the Week: What Do You Expect for Commodity Costs in 2019?

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. Planet Fitness Brand Discussion, Valuation and Outlook

    a. Background: I saw a recent article on social media announcing that United PF Partners has become the first Planet Fitness franchisee to reach 100 locations. From the Planet Fitness website, United PF was formed two years ago, in November 2016, by JLM Financial Partners and Eagle Merchant Partners with the merger of several leading Planet Fitness franchisees and the overall goal of accelerating growth and further providing access to non-intimidating fitness environments where members can build active lifestyles for an affordable price. Today, United PF Partners has grown to 110+ clubs across 10 states (primarily in the South and Midwest), employs over 1,500 people, and serves over 850,000 members.
    b. From a brand perspective, Planet Fitness was founded in 1992 in Dover, NH. As of September 30, 2018, Planet Fitness had more than 12.2 million members and 1,646 stores in 50 states, with recent growth internationally as well. Planet is known for the $0 down and $10 per month membership, their purple and yellow colors, and for their Judgement Free Zone®.
    c. Comments: Planet Fitness has been on a tear recently, with several private equity firms entering the business over the past several years through acquisitions of small and mid-scale Planet operators. There are several critical reasons why – 1. EBITDA margins in these clubs can eclipse 40-45% of sales, which is almost unheard of in the franchising world, 2. The cost to build is very high as locations can be 20,000 square feet. In order to meet aggressive new unit development targets, large amounts of outside capital are needed, 3. Sales growth remains robust at Planet Fitness as there is seemingly no end to the amount of people who will pay $10 per month for a membership – even if they don't use it, and 4. Fitness franchising has low labor costs and is very easy to operate when compared to the traditional model of restaurant

franchising. This is certainly appealing to outside groups looking to acquire a new franchise business.

d. Effect on M&A: Valuations are red hot for Planet Fitness club acquisitions, with some rumored franchise club deals trading for over 10X of EBITDA. This puts Planet valuations at the very top of the franchise industry, even higher than Taco Bell and Dunkin'. New unit development has been driving these valuations as territories are getting filled-in. At EBITDA margins of 40-45% of sales at the club level, investors and buyers see new unit development as a way to significantly lower the total cost of acquisition. Planet's stock price has doubled in the past year as well. As more than a half-dozen PE and financial groups have entered the Planet Fitness space, expect new unit development to continue quickly until the brand reaches saturation.

e. The brand has publicly said that it thinks in can grow to 4,000 locations. This seems to be too high to me – could there be 50 million members at Planet Fitness, which would represent over 15% of the population in the US? The likely scenario here is that the franchise base will continue consolidating at the hands of these larger financial groups. Then, in several years, when development and sales slow, these groups will sell to larger institutions, seeking to maximize their returns. For now, expect the sky-high valuations to continue. Planet Fitness has been a great story. However, also keep watching with a bit of caution – the gym space has had a very checkered past on a national level in terms of successes and failures.

B. Brand Affinities for Gen Z Consumers

a. ***Background***: I read a recent article about Gen Z by Nicholas Upton at Franchise Times. The thrust of the article was defining metrics to measure brand affinity among Gen Z consumers. To start, Gen Z is defined by age group as being born between 1995-2015 – so, they are between 4 and 24 years old. As a society, we have talked about the impact of Millennials for several years. Today, you can hardly go to a franchise convention of any kind and not hear substantial conversations about how to appeal to this age group. But what about Gen Z? The oldest part of this demographic is now entering the work world, and they are unique – much like baby boomers were different than Gen X – and Gen X is distinct from Millennials.

b. This article pointed out 6 key areas that are important to Gen Z when choosing brands – 1. Social circle – is the brand part of the cultural conversation?, 2. Self – if there a true emotional connection with the consumer? 3. Innovative, 4. Trusted – is the brand consistent?, 5. Purpose – does the brand add good to society? and 6. Accessible – is the brand hyper-useful?

c. ***Effect on M&A***: I have said it for the past few years, but if your brand does not cater to Gen Z consumers, I would be worried and push for change. I would also encourage financial investors, family offices and PE firms to consider Gen Z prior to making large acquisitions into a brand. My kids are 14 and 11, and they love Taco Bell, Chick-fil-A, Krispy Kreme, Blaze Pizza and Panera, among others. I know it is a small sample size, but I rarely hear them talking about some of the other notable Tier 1 franchise concepts. To me, emotional connection, innovation and accessibility are areas that deserve a brand's attention as they think about attracting Gen Z consumers. And as a long-time restaurant guy who has witnessed years and years of value pricing and menu discounting – at the expense of product innovation – this is a hot-button to me. Few consumers want to associate with a brand that isn't fresh and innovative.

C. Skepticism of Third-Party Delivery Platforms

a. ***Background***: At the recent ICR Conference, Carrol's CFO Paul Flanders remarked that delivery economics are probably marginal for operators, and that they were not eagerly embracing delivery. Carrol's is a publicly-traded 800+ unit Burger King franchisee that started in 1960.

b. *Comments*: This sentiment is quite common, I think, with franchisees. Many of my friends and colleagues are quite cautious about delivery for several reasons – marginal profitability due to high fees, product quality concerns and fears over lack of control. Incrementality is also a concern – the salient question is this – will delivery grow sales, or just replace dine-in sales? And if profitability of delivery is questionable, replacing sales (instead of growing them) will be disastrous to a franchisee's P&L over time.
c. As Jonathan Maze points out in a recent article, almost all franchisors have a different view. They love the technology, data collection capabilities and possibility of incremental sales that are offered from espousing delivery. Even if it is a loss leader, a brand cannot afford to under-invest in delivery when their competitors are focusing on it intensely. However, a franchisor is incentivized by different things than a franchisee. Franchisors want higher sales, larger royalty dollars and better data for branding decisions. Franchisees generally care about profit more than anything else. It is all part of the healthy push-and-pull relationship between a franchisee and franchisor.
d. *Effect on M&A*: Delivery isn't a cure-all for a struggling brand. It might even be a necessary loss-leader that results in lower EBITDA. I remember the old multibrand days at Yum – combining two concepts under one roof to drive higher sales and profits. It was a great idea and initially successful, but it was rolled out way too quickly and before it was adequately tested, resulting in largely a failure over the course of a decade as performance eroded. I hope today's brands don't make the multibrand mistake of moving too fast and instead have a cautious mindset with third-party delivery – or it could have a serious effect on valuations in a way that many people do not expect.

D. Question of the Week: What Do You Expect for Commodity Costs in 2019?
   a. After experiencing a mostly flattish food cost environment in 2018, general trends point to slightly lower food costs for 2019, mostly ranging at (2%) – (3%) across chicken and beef. The BLS Foodstuffs Index declined for the 3rd consecutive month and ended 2018 down -1.3% y/y with cheese reaching a new 12-month low as reported by Restaurant Research. Slightly declining food costs are a relief to many restauranteurs, who are facing uphill battles in containing other costs in their P&Ls - rising minimum wage, increased natural gas prices, higher insurance expenses, increased remodeling costs and many others. Let's hope for lower food prices in 2019 as we move throughout the year.

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.