COMPASS™
Restaurant Consulting & Research

EOM Report // March 2020

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COMPANIES MENTIONED IN THIS REPORT:

CORE COVERAGE

*Charts on pages 6-25 "Mean" Source – Company Filings

SUMMARY OF INDUSTRY BUSINESS CONDITIONS:

DISCLAIMER: There is a larger than normal spread in the range of our SSS primarily because when we began our EOM polling of our contacts for the Pulse Report some areas of the country were still allowing restaurants to have uninterrupted services (opened Dining Rooms; normal hours of operations; full menus; Drive-Thru; Take-Out/Delivery; etc.) thus creating a disparity in reporting SSS. As we neared the deadline the municipalities and federal government required mandatory closures of all Dining Rooms which spiked the negative sales.

HEADLINE NEWS: **(see pg. 4-6 for details)**:

I. COVID-19's Devastating Impact on the Restaurant Industry.

II. Federal Government Passes Several Stimulus Bills to Help Small Business and general Populous.

III. Many Americans, Both Companies and Individuals, Pulling Together to Fight COVID-19.

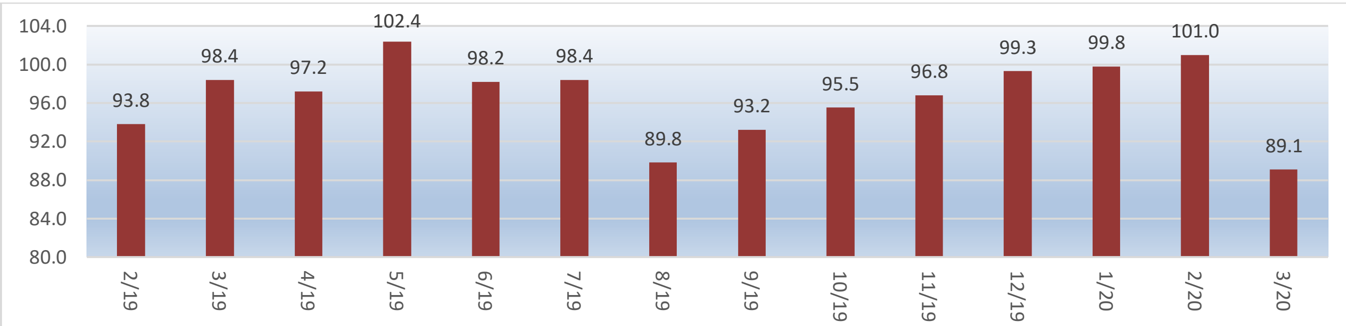
IV. Sector Summary: QSR, Fast Casual, Casual, Fine Dining.

APRIL OUTLOOK

- **Brands we expect to outperform the Industry**
  - Chipotle
  - Domino's
  - Longhorn
  - Pizza Hut
  - Wingstop
- **Brands we expect to underperform the Industry**
  - Casual Dining Sector

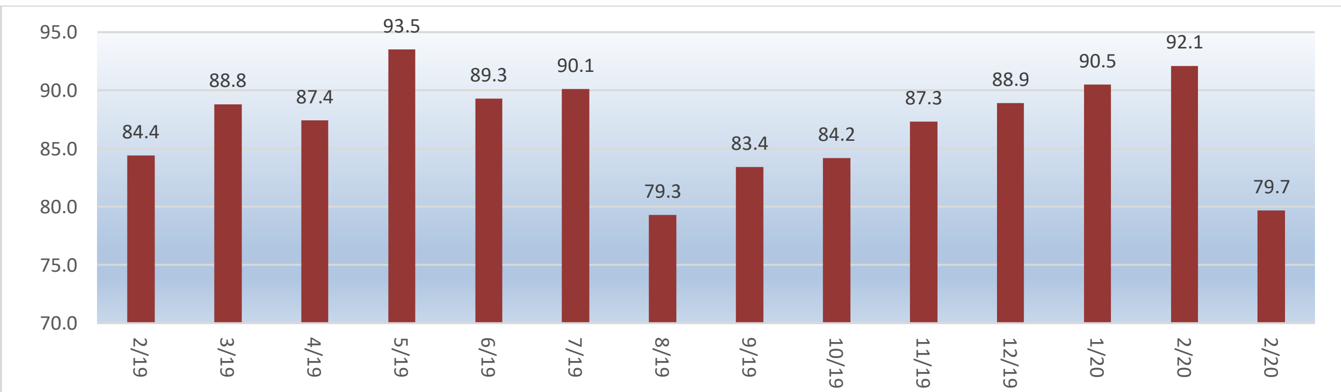
Please see Page 26 for Important Disclosures.

I. VIEW OF THE ECONOMY – CONSUMER SENTIMENT



Source: University of Michigan Survey of Consumers

II. VIEW OF THEIR PERSONAL FINANCES



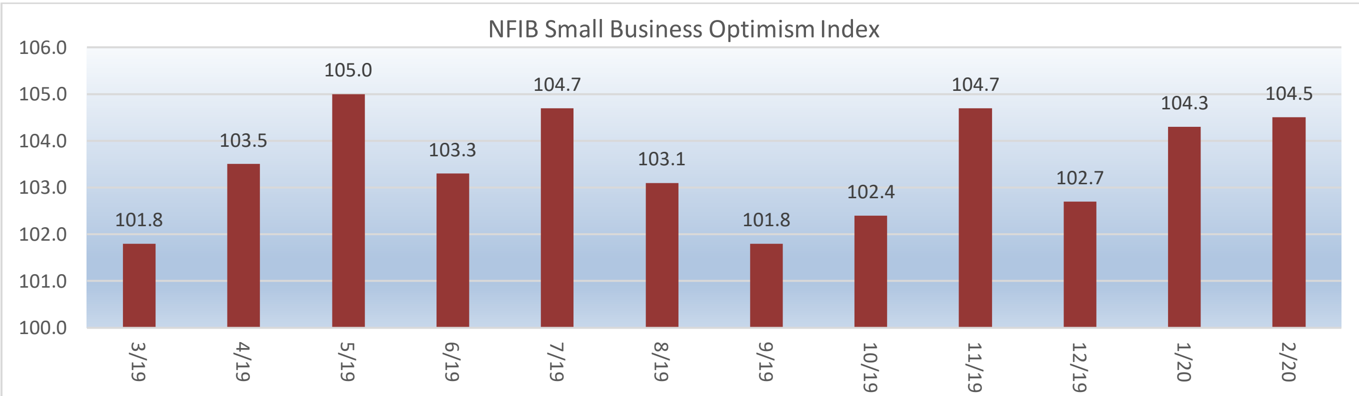
Source: NFIB Survey

OUR TAKE:

The COVID-19 pandemic has taken a toll on consumer's confidence and future outlook. Consumer sentiment dropped 11.9 index points in March, the fourth largest one-month decline in nearly a half century. The steepest monthly decline was barely larger at <12.7> index points in response to the deepening recession in October 2008. The 1980 and 2008 collapses in consumer confidence sparked long and deep recessions. The Katrina decline was reversed within three months, and some observers compared that "V" shape response was the recovery of New Orleans, a closer comparison to today's national economy. Stabilizing confidence at its month's end level will be difficult given surging unemployment and falling household incomes. The extent of additional declines in April will depend on the success in curtailing the spread of the virus and how quickly households receive funds to relieve their financial hardships. Mitigating the negative impacts on health and finances may curb rising pessimism, but it will not produce optimism.

Some additional statistics and food for thought . . .

- Black Box Intelligence reported on April 1 that grocery sales are up 73% in comparable sales.
- Gallup Poll – Consumer Poll March 13-22:
  - 66% are worried but not panicing (this impacts confidence).
  - 52% believe this will lead to a recession.
  - 67% reported being financially impacted by the crisis.
  - 82% said they are avoiding crowds.
  - 72% are avoiding public places.
  - 81% reported life has been disrupted.
  - 86% reported eating at home more, altering eating habits, avoiding restaurants.



Source: NFIB Survey / Compass RCR Monthly Survey

COMMENTS:

With the sudden and rapid advent of the COVID-19 pandemic, many restaurant operators were unsuspecting of the severity the impact would have on their business. The impact was not gradual or predictable; quite literally, their business came to an abrupt change. Sales are growing, Dining Rooms are full and the next day their sales are down anywhere from 50% to 90%.

According to the recent NFIB survey (April 2, 2020), 92% of small business owners reported the COVID-19 outbreak was having a negative impact on their business,. 80% reported slower sales, 31% reported disruptions in their supply chains, 35% reported being able to operate their business 1-2 months under current economic conditions. And according to Technomic's latest report (3/27/20), restaurant operators top concerns were: 90% sales, 89% profits, 87% employee health. Of those operators who haven't closed their doors, most are focusing on an Off-Premise model but admit this will not sustain their business for the long-term. Generally, what we heard, operators are stressed and discouraged over the future for them and their business.

But some of the comforting prospects to this dire situation are the way businesses, franchisors, and customers are rallying to offer relief efforts.

Operator Relief Efforts:

- Royalty relief with franchisors extending deadlines
- Rent deferments
- Crowdfunding to assist struggling restaurants
- Great American Take-Out Tuesday
- Government relaxation of alcohol delivery restrictions
- Waiving of delivery subscription fees
- Delays for remodeling and other reinvestments
- Shifting menus to focus on the most important and operationally effective menu items.
- Chains tapping into credit
- Just passed Congress – the federal stimulas package

What are operators doing to attempt to stem the tide of their declining sales? Just to name the most popular:

1. Most are pivoting to Off-Premise model
2. Offering free Delivery
3. Reducing menus and hours of operations
4. Several chains and independents are offering meal kits and/or family meal bundles
5. Improving cleanliness and sanitization practices
6. Offering paid sick leave
7. Comminicating with their customers with messaging such as "we're in this together", "locally owned"
8. Engaging customers through their App – offering deals
9. Several independents and chains are offering essentials such as: bread, milk, eggs, butter, etc. focusing on core menu items

Operators have been hit hard; but many are fighting back!

March 2020 EOM Overview:
SSS / Unit Managers Morale

With the rapidly expanding impact of COVID-19 on the restaurant industry, for March's report we wanted to hear how unit level managers were coping with the crisis. This is the summary of that poll. Specific chains are covered under their respective, regular reports.

The rankings listed below range from 1 to 10 with 10 representing the highest level and 1 the lowest level. The higher morale is directly correlated to the level of communication unit level managers have received during this period.

BRAND	SSS	MORALE	OUTLOOK	STRESS
McDonald's	(25-30%)	5	Negative 4	7
Burger King	(30-35%)	4	Negative 3	8
Wendy's	(20-30%)	5	Positive 5	8
Jack in the Box	(23-27%)	6	Positive 5	7
Popeyes	(12-14%)	7	Positive 6	6
KFC	(37-42%)	3	Negative 3	9
Del Taco	(26-30%)	4	Negative 8	8
Taco Bell	(23-46%)	5	Positive 5	6
Pizza Hut	(14-16%)	4	Negative 4	7
Domino's	+5-8%	8	Positive 8	4
Chipotle	(8-10%)	7	Positive 8	7
Starbucks	(30-35%)	7	Positive 8	6
Wingstop	+6-8%	8	Positive 8	6
Applebee's	(80-90%)	3	Negative 3	9
IHOP	(65-75%)	4	Negative 4	7
Chili's	(65-70%)	6	Negative 4	6
Chuy's	(60-70%)	3	Negative 4	8
Longhorn	(40-50%)	7	Positive 6	6
Olive Garden	(45-55%)	6	Positive 5	7
Red Robin	(65-75%)	7	Positive 6	8

HEADLINE NEWS DETAILS:

I. **COVID-19 – Devastating Impact on the Restaurant Industry:** The recently released jobs report (Friday 4/3/20) showed some alarming numbers; a staggering loss of 701,000 jobs in March – one of the largest monthly losses in history. But, a closer examination shows almost 60% of the 701,000 lost jobs came from the food service industry. The National Restaurant Association's (NRA) recent survey found the industry has lost more than 3 million jobs (existing, future, furloughed, hiring projections and reduced hours are included in this). According to the NRA, the industry employs 10% of the U.S. workforce or about 15.6 million people. The Association is also projecting an additional 5.7 million jobs lost in April/May. Additionally, the Association reported over 30,000 locations closed in March and is projecting an additional 100,000 closures in April/May. This total would represent approximately 14% of restaurants in the U.S.

The survey found: 70% of restaurants have laid off employees and reduced number of hours; 50% expect doing more in the next 30-60 days. An average 170 million Americans visit restaurants everyday (prior to the crisis). With all the "Shelter in Place", Social Distancing, employees laid off, and other employees now working from home – what will this look like? As of March 17, 2020 restaurant traffic was down 48.6% according to Open Table.

Thus far, COVID-19's impact on the restaurant industry has been devastating. Many Independents and Chains that are over leveraged might not survive. Time will tell and April will be a telling month.

HEADLINE NEWS DETAILS (continued):

II. **Federal Government Passes Several Stimulas Bills to Help Small Business and General Populas:** There is so much information being thrown at small businesses regarding stimulus packages so rather than write about the details we defer to the following websites for explanations.

- www.restaurant.org
- www.sba.gov

III. **Many Americans, Companies and Individuals, are Pulling Together to Fight COVID-19:** The President continues to ask companies to assist in helping the country fight COVID-19. Along with many companies who have thus far stepped up are numerous individuals who are starting movements offering help and aid. Everything from launching Go Fund Me campaigns for their favorite restaurant, to volunteering to assist the medical professionals on the front lines (a nurse from the Midwest who had the virus and recovered has volunteered to go to NYC to offer aid). A movement known as "Take-Out Tuesday" where people are encouraged to support their favorite restaurants was started by an individual and the NRA took up the Cause as well as much of the restaurant media. The list continues to grow.

Restaurant companies are offering free meals to 1st Responders while other industrial companies are manufacturing masks, ventilators, hand sanitizers, and other protective equipment. Others are making monetary donations. This list continues to grow as well.

IV. **Summary of Industry Sectors:**

QSR: The QSR sector is enduring the COVID-19 crisis better than all other sectors; averaging <30-40%> drop in sales. This is a result of QSR's inherent evolvement through the years towards Off-Premise consumption (with Drive-Thru's accounting for 55-65% of sales, Take-Out 10-15% of sales; leaving only 10-20% for Dine-In). And in the QSR sector Pizza is actually showing positive sales during the crisis. This is a natural conclusion since Pizza expanded their food Delivery business and made it the core of their DNA in the 1980s. Most QSR's reported similar actions taken during the crisis – reduced menu, Free Delivery, reduced staff, reduced hours of operations. Operators concerns: employee wellbeing – 89%; concern over their business surviving the crisis – 78%; concerned with the sales – 90%; concerned with profits – 89%.

The news and the impact COVID-19 is having has been all negative and increasing the sense of hopelessness. Then Domino's announced they were hiring 10,000 more drivers permanently. That became a tipping point in the COVID-19 narrative. Shortly after Domino's announcement other Pizza chains announced they were hiring more Delivery drivers as well. Then grocery stores and Amazon, etc. all jumped on the bandwagon. This provided some hope and positive messaging in the deluge of negative news.

Several other factors supporting the better than industry sales performance are: (1) Consumers are seeking more comfort foods during this crisis (Pizza and Burgers top the list). (2) Consumers are seeking more value as unemployment rises and uncertainty over their employment future increases.

We expect McDonald's, Wendy's, Popeyes, and Taco Bell to endure the best and KFC, Del Taco, Jack in the Box to be the worst. This is based on Corporate initiatives (to date) and operators' efforts to get through this critical calamity.

Fast Casual: The Fast Casual sector is experiencing a substantial negative impact on sales during the crisis for the most part with sales loss in the <45-55%> range. This is primarily a result of their business model not being designed for Off-Premise; although a few chains such as Chipotle, Wingstop, Panera, Jimmy John's have adopted an Off-Premise model prior to the Crisis and from our coverage list, Chipotle and Wingstop are doing the best with Wingstop being positive in sales. The shocking news was Shake Shack being down <80%>. Most Fast Casual operators are incorporating similar tactics as their sector leaders to deal with the crisis.

We expect the Fast Casusal sector to survive the crisis but will have many Brand casualties as well as individual unit closures; with publicly traded chains of Wingstop and Chipotle doing the best and Shake Shack the worst. This is based on how Corporate is responding to the crisis and how some chains, prior to the crisis, had incorporated initiatives that made their brand adaptable to the Off-Premise model.

HEADLINE NEWS DETAILS (continued):

Casual Dining: The Casual Dining sector is getting hit very hard during the crisis with negative sales of <70-80%>. This is primarily a result of the sector not being designed for Off-Premise dining. Although in recent years most Casual Dining chains have made some adaptations to an Off-Premise model (prior to crisis). Another aspect impacting this sector is in recent years they have been losing marketshare; essentially because they have lost touch with their core customer base. The exceptions are Olive Garden, Longhorn Steakhouse and Texas Roadhouse; but, ironically this group has done little in developing an Off-Premise model. Prior to the COVID-19 crisis, most Casual Dining chains were making some efforts to adapt to more of an Off-Premise model or at least adapt an Off-Premise component for their existing model.

We expect the Casual Dining sector to take the biggest hit from the crisis with many locations and a few chains closing; with Olive Garden, Longhorn Steakhouse, Chili's and Outback Steakhouse performing the best and chains like Applebee's suffering the worst. This is based on Corporate's initiatives and responses to the crisis and their reserve cash on which to draw.

Fine Dining: The Fine Dining sector has been hardest hit from the crisis with negative sales of <80-90%>. The Fine Dining model is based on a premium dining experience and had primarily offered very little Off-Premise options. Most Fine Dining chains are making some very creative ways to modify their high dining experience model to Off-Premise. The majority are offering limited menus for Curbside and Delivery with very high quality packaging.

We expect the Fine Dining sector to survive the crisis with very few closures. This is based on their deep capital reserves. It is interesting to note how chains like Ruth's Chris, Capital Grille, and Maggiano's have adapted to Curbside and Delivery using a limited menu. We foresee Ruth's Chris and Capital Grille achieving the best response and surviving the crisis.

SOURCE: Sales percentages provided by Datassentials and Compass RCR.

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