



What's Inside This Commentary

Same-Store Sales Discussion and Analysis	1
Same-Store Sales Data	2
Restaurant Sales Reporting Dynamics	4
A Note on the Proposed Capex Tax Credit	5

Same-Store Sales Discussion and Analysis

The second quarter of 2010 saw gradual improvement in the restaurant industry, but soft customer traffic continues to be an issue. However, on a year-over-year basis, the rate of decline in traffic has been moderating, with QSR performing the best with the lowest decline rates. Improved performance has helped to soften the traffic declines to some extent. However, casual and fine dining continue to suffer, with much steeper decline rates.

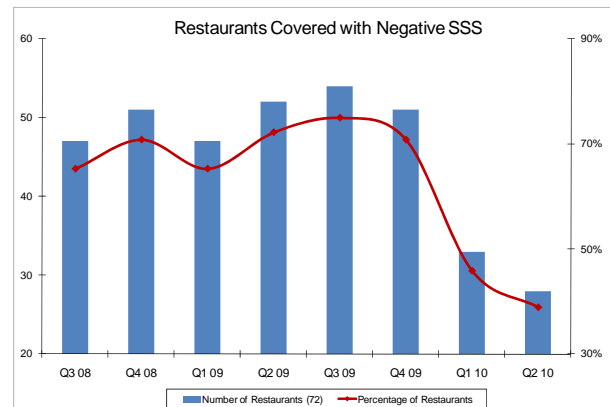
In fine dining, the companies we track were up by an average of 3.8% for the second quarter of 2010. It is important to note that these positive sales comps are much lower than the dramatic sales declines (an average of -19.1%) the segment experienced during the same quarter of 2009, and therefore their sales are still well below pre-recession levels.

In casual dining, 13 of the 24 concepts that we track were negative for the second quarter with the segment down by an average of (0.1%). Several concepts have begun to show gradual improvement as they comp over the severe declines in 2009. However, according to Knapp Track, casual dining guest counts were down by 3.3%, 3.9% and 3.4% for April, May and June respectively, so a portion of the same store sales stabilization is attributable to price increases as opposed to a return of the consumer.

All five of the family dining concepts that we track reported negative sales during the quarter with the segment down by an average of (3.2%). The fast casual segment ended the quarter with the best performance in the restaurant industry for the fourth consecutive quarter. The segment was positive by 3.8% for the second quarter of 2010, with seven of the nine concepts we track reporting same-store sales growth.

In the QSR segment, 10 of the 21 concepts we track were negative during the second quarter of 2010 while the segment was up by an average of 0.1%. This is the first time the QSR segment has been positive since early

2008. Again, these gradual improvements have more to do with comping over negative numbers opposed to increased traffic and sales.



* For purposes of comparison, excludes concepts that do not have SSS data for all 8 qtrs.

The second half of 2010 should continue to bring gradual improvements to restaurant industry same-store sales as the industry faced extremely tough challenges through the end of 2009 due to the economic turmoil that resulted in weak labor and tight credit markets, resulting in lower discretionary spending. Restaurants have been trying to win back cash-conscious guests who have been reluctant to shell out more disposable income, preferring to dine at home or spend less per meal. Concepts are tweaking entrées, revamping promotions and focusing on value menus.

We expect these trends to remain in place over the near to medium term, with consumers continuing to look for value, distinct dining experiences, convenience and enhanced menu deals. Although the economy is struggling to improve, albeit at a modestly lower rate than earlier expected, the sluggish labor market, over supply of restaurants in the industry, and food cost inflation will continue to weigh on industry profitability.

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Same-Store Sales ("SSS") Data

	<u>Q3 08</u>	<u>Q4 08</u>	<u>Q1 09</u>	<u>Q2 09</u>	<u>Q3 09</u>	<u>Q4 09</u>	<u>Q1 10</u>	<u>Q2 10</u>
Fine Dining:								
Fleming's	-9.7%	-20.8%	-19.9%	-22.4%	-18.0%	-5.7%	5.2%	9.0%
McCormick & Schmick's	-5.5%	-13.5%	-13.9%	-17.3%	-18.8%	-12.9%	-9.6%	-4.0%
Morton's Rest. Group	-7.6%	-12.0%	-24.1%	-26.1%	-16.8%	-5.3%	3.6%	7.1%
Ruth's Chris	-6.9%	-18.5%	-18.5%	-23.4%	-24.0%	-11.2%	-0.5%	2.9%
Mean	-7.4%	-16.2%	-19.1%	-22.3%	-19.4%	-8.8%	-0.3%	3.8%
Same Store Negative Count¹	4	4	4	4	4	4	2	1

Casual Dining:

Applebee's	-3.1%	-4.6%	-3.0%	-4.3%	-6.5%	-4.5%	-2.7%	-1.6%
Benihana	-6.5%	-11.1%	-10.4%	-10.1%	-9.9%	-3.4%	1.4%	2.4%
Big Boy & Golden Corral	0.4%	-0.1%	1.1%	4.6%	-2.4%	-2.0%	-3.4%	-1.7%
BJ's Restaurants	-1.0%	-0.7%	-0.1%	-1.3%	-1.6%	-0.2%	4.4%	5.3%
Bonfisi's	-10.2%	-11.5%	-10.0%	-8.2%	-5.8%	1.0%	3.6%	5.7%
Buffalo Wild Wings	3.8%	3.2%	6.1%	3.4%	1.5%	2.2%	0.5%	-0.5%
California Pizza Kitchen	-2.4%	-7.2%	-5.9%	-6.5%	-8.0%	-5.8%	-2.7%	-5.9%
Carrabba's Italian Grill	-5.7%	-6.5%	-7.3%	-5.9%	-7.5%	-3.6%	1.1%	3.5%
CEC Entertainment	1.1%	-1.5%	-0.1%	-5.4%	-3.1%	-2.0%	0.7%	-2.2%
Cheesecake Factory	-4.7%	-7.0%	-3.2%	-3.0%	-2.4%	-0.7%	2.7%	1.6%
Chili's Grill & Bar	-3.0%	-4.2%	-5.2%	-9.4%	-6.0%	-3.2%	-5.0%	-4.1%
Dave & Buster's	-6.0%	-10.2%	-7.9%	-6.5%	-7.4%	-5.8%	-2.5%	-
Famous Dave's	-4.7%	-8.3%	-5.5%	-9.4%	-6.8%	-3.4%	-3.5%	0.6%
Granite City	-	-	-11.2%	-13.2%	-12.7%	-8.1%	2.1%	5.3%
Landry's	-2.0%	-4.7%	-9.0%	-8.0%	-6.5%	-5.0%	-2.0%	0.0%
LongHorn Steakhouse	-4.9%	-5.7%	-5.4%	-6.5%	-7.0%	-0.8%	1.9%	1.8%
Macaroni Grill	-9.0%	-10.6%	-	-	-	-	-	-
Maggiano's	-3.3%	-6.9%	-9.5%	-9.2%	-6.6%	-1.6%	1.9%	1.3%
O'Charley's	-4.0%	-6.1%	-2.9%	-6.9%	-7.6%	-7.3%	-6.7%	-7.9%
Olive Garden	2.4%	0.8%	-1.4%	-0.6%	-2.9%	-1.4%	1.5%	-1.5%
On The Border	-3.3%	-3.7%	-5.0%	-5.8%	-5.1%	-4.7%	-	-
Outback	-7.9%	-9.1%	-8.4%	-10.2%	-10.7%	-5.9%	-2.9%	3.6%
PF Chang's Bistro	-3.1%	-7.1%	-6.6%	-6.8%	-8.5%	-5.2%	-2.7%	0.1%
Real Mex	-3.7%	-6.5%	-9.1%	-	-	-	4.3%	-2.2%
Red Lobster	-3.7%	0.3%	-4.6%	-0.6%	-7.9%	-8.4%	0.9%	-4.6%
Red Robin	-2.4%	-6.7%	-7.8%	-11.1%	-14.8%	-10.9%	-2.3%	-1.4%
Ruby Tuesday	-10.8%	-10.8%	-6.8%	-3.2%	-3.1%	-1.7%	-0.7%	0.3%
Stoney River	-8.1%	-18.2%	-17.2%	-20.4%	-17.1%	-10.3%	-8.3%	-0.7%
Taco Cabana	-0.9%	0.5%	-1.6%	-3.8%	-4.3%	-4.5%	-2.0%	-0.1%
Texas Roadhouse	-3.2%	-4.9%	-1.4%	-3.7%	-4.4%	-2.3%	0.5%	1.5%
Mean	-3.8%	-5.8%	-5.5%	-6.1%	-6.6%	-3.9%	-0.7%	-0.1%
Same Store Negative Count¹	20	20	22	22	23	22	13	12

Family Dining:

Bob Evans	-2.5%	-1.3%	-1.6%	-3.0%	-2.8%	-4.2%	-4.1%	-3.5%
Cracker Barrel	-3.2%	-1.5%	-0.9%	-1.4%	0.6%	-0.2%	0.6%	-
Denny's	-5.1%	-6.1%	-1.1%	-4.2%	-7.2%	-7.0%	-6.2%	-5.9%
IHOP	0.2%	-1.0%	2.0%	-0.6%	-1.1%	-3.1%	-0.4%	-1.0%
Luby's	-6.7%	-3.2%	-8.9%	-13.6%	-13.3%	-12.5%	-4.8%	-
Ninety Nine	-8.1%	-8.4%	-4.5%	-10.0%	-7.1%	-6.5%	-6.0%	-0.5%
Perkins	-3.7%	-3.9%	-4.9%	-8.3%	-7.5%	-5.6%	-5.7%	-5.1%
Mean	-4.2%	-3.6%	-2.8%	-5.9%	-5.5%	-5.6%	-3.8%	-3.2%
Same Store Negative Count¹	5	6	5	6	5	6	3	3

¹ For purposes of comparison, excludes concepts that do not have SSS data for all 8 quarters

* Source: Restaurant Research LLC, Capital IQ and company filings

SSS Data (Con't)

	<u>Q3 08</u>	<u>Q4 08</u>	<u>Q1 09</u>	<u>Q2 09</u>	<u>Q3 09</u>	<u>Q4 09</u>	<u>Q1 10</u>	<u>Q2 10</u>
Fast Casual:								
Chipotle	3.1%	3.5%	2.2%	1.7%	2.7%	2.0%	1.3%	8.7%
Cosi	-0.1%	-6.9%	-11.3%	-12.2%	-10.7%	-11.9%	-3.4%	3.1%
Einstein Noah Bagel	-1.7%	-3.3%	-5.7%	-2.2%	-3.1%	-1.4%	0.1%	-2.2%
Panera Bread	3.3%	2.7%	0.7%	-0.4%	2.8%	5.4%	9.5%	9.9%
Pei Wei	-2.9%	-6.1%	-2.2%	-0.1%	-0.7%	3.0%	2.2%	3.0%
Qdoba Mexican Grill	-1.0%	-1.1%	-2.3%	-2.8%	-3.1%	-1.7%	3.1%	4.6%
Rubio's Restaurants	-2.1%	-0.2%	1.9%	0.9%	-2.7%	-2.7%	-1.8%	-3.3%
Steak n Shake	-7.4%	-1.4%	2.4%	5.0%	10.1%	14.4%	5.1%	7.5%
Tim Horton's (US)	-0.6%	-0.1%	3.2%	3.3%	4.3%	2.1%	3.0%	3.1%
Mean	-1.0%	-1.4%	-1.2%	-0.8%	0.0%	1.0%	2.1%	3.8%
Same Store Negative Count¹	7	7	4	5	5	4	2	2
QSR:								
Chicken:								
Church's	4.0%	2.1%	1.5%	-5.6%	-	-	-	-
El Pollo Loco	0.0%	-2.5%	-5.9%	-6.8%	-10.1%	-10.0%	-6.7%	-4.9%
KFC	-6.0%	-3.0%	-7.0%	3.0%	-2.0%	-8.0%	-4.0%	-7.0%
Pollo Tropical	-1.9%	-3.6%	-3.0%	-3.1%	-0.1%	0.3%	3.7%	6.3%
Popeyes	-2.8%	-2.8%	-0.3%	4.3%	-0.3%	-1.0%	-0.4%	0.4%
Mean	-1.3%	-2.0%	-2.9%	-1.6%	-3.1%	-4.7%	-1.9%	-1.3%
Same Store Negative Count¹	3	4	4	2	4	3	3	2
Coffee/Snack:								
Caribou Coffee	-4.7%	-5.1%	-5.0%	-3.3%	-0.5%	0.2%	5.2%	4.8%
Jamba Juice	-10.3%	-12.0%	-13.8%	-13.7%	-5.3%	-5.3%	-3.3%	-2.4%
Krispy Kreme	-11.8%	1.9%	2.1%	5.9%	5.1%	1.1%	3.4%	5.7%
Starbucks	-8.0%	-10.0%	-8.0%	-6.0%	-1.0%	4.0%	7.0%	9.0%
Mean	-8.7%	-6.3%	-6.2%	-4.3%	-0.4%	0.0%	3.1%	4.3%
Same Store Negative Count¹	3	3	3	3	3	1	1	1
Mexican:								
Taco Bell	9.0%	9.0%	2.0%	1.0%	-2.0%	-5.0%	-2.0%	1.0%
Mean	9.0%	9.0%	2.0%	1.0%	-2.0%	-5.0%	-2.0%	1.0%
Same Store Negative Count¹	0	0	0	0	1	1	1	0
Pizza:								
Domino's	-6.1%	-3.0%	1.0%	-0.7%	0.0%	1.4%	14.3%	8.8%
Papa John's	1.7%	-2.0%	0.3%	0.1%	0.0%	-0.5%	-0.4%	0.4%
Pizza Hut	5.0%	-1.0%	-3.0%	-8.0%	-13.0%	-12.0%	5.0%	8.0%
Sbarro	-1.0%	-8.0%	-4.8%	-5.1%	-5.2%	-4.6%	-1.6%	-0.9%
Mean	-0.1%	-3.5%	-1.6%	-3.4%	-4.6%	-3.9%	4.3%	4.1%
Same Store Negative Count¹	2	4	2	3	2	3	2	1
Sandwich:								
Arby's	-5.0%	-8.5%	-8.7%	-6.9%	-9.0%	-11.0%	-11.5%	-7.4%
Burger King	3.0%	1.7%	1.6%	-4.5%	-4.6%	-3.3%	-6.1%	-1.5%
Carl's Jr.	0.5%	-0.6%	-5.1%	-6.1%	-5.2%	-8.7%	-6.4%	-6.4%
Hardee's	1.3%	1.5%	2.5%	-2.7%	-1.8%	-2.5%	-1.8%	1.7%
Jack in the Box	-0.8%	1.7%	0.4%	-1.0%	-6.0%	-11.1%	-8.6%	-9.4%
McDonald's	4.7%	5.0%	4.7%	3.5%	2.5%	0.1%	1.5%	3.7%
Sonic Drive-In	-0.6%	-3.6%	-3.6%	-5.4%	-4.5%	-6.5%	-13.2%	-6.0%
Wendy's	0.1%	3.7%	1.0%	-0.4%	-0.1%	-3.0%	0.8%	-1.7%
Mean	0.4%	0.1%	-0.9%	-2.9%	-3.6%	-5.8%	-5.7%	-3.4%
Same Store Negative Count¹	3	3	3	7	7	7	6	6
Mean Total QSR	-1.4%	-1.8%	-2.3%	-2.8%	-3.0%	-4.1%	-1.2%	0.1%
Same Store Negative Count - QSR¹	11	14	12	15	17	15	13	10

¹ For purposes of comparison, excludes concepts that do not have SSS data for all 8 quarters

* Source: Restaurant Research LLC, Capital IQ and company filings

Restaurant Sales Reporting Dynamics

Since the onset of the financial crisis in 2008, some restaurant companies have struggled with their messaging and public reporting. Overwhelmed by declining sales and traffic as well as margin pressures, there hasn't been a consistent fountain of good news to report to constituents such as shareholders, bondholders, suppliers and lenders. As a result, many companies have begun to rely on temporary strategies which may provide short-term relief, but can also impact long-term brand perception, franchisee profitability and consumer behavior either positively or negatively. Given the new increased scrutiny by the SEC, we believe it is important for restaurant companies to consider increasing the quality of their disclosure particularly concerning *price* and *traffic* components of same-store sales as well as franchisee margins with respect to certain promotions and discount programs.

A brief trip down memory lane with regard to the history of same-store sales reporting is probably helpful at this point. In the early 1980s, many retailers were expanding at a torrid pace and overall sales were increasing dramatically. However, in some cases, unit sales were falling while overall sales were increasing due to new store development. Consequently, the investor relations world adopted same-store sales reporting as a key focus rather than just overall sales. This enabled investors, creditors and other constituents to distinguish existing store sales from new store sales in order to more properly assess brand performance. This was considered by stockholder advisory firms such as ISS, a positive development for retailer reporting. Accordingly, *same-store-sales* have become the standard in retail reporting as opposed to overall sales.

Reporting retail performance always has to balance short-term information needs with long-term business strategy. Often, the capital markets spend too much time dwelling on short-term results at the expense of the patience required to build a brand. Accordingly, we are very sympathetic with investor relations departments that have to struggle with the constant need for information in the 24-hour financial news cycle. More importantly, restaurant companies have to balance investors' need for information with the confidentiality of the performance of their competitive strategies. This of course can lead to very difficult disclosure philosophies and decisions. However, an appropriate balance and consistency has to be struck by each company with regard to informing their constituents about how the company is truly performing. Consequently, we believe it is difficult to rationalize in this challenging environment, the avoidance of reporting both *price* and *traffic* components of same-store sales since price can be used to generate traffic at the expense of overall margin.

A similar dilemma has cropped up with some recent strategies for combating soft traffic. Most restaurant executives properly understand the need to balance strategies introduced to defend market share, with overreliance on discounting which may be long-term destructive to franchisee financial health. For example, certain couponing, discounting and limited time offerings ("LTO") are necessary to revive traffic or combat competitors' promotions and offerings. However, franchisors who *go to the well too often* with this strategy may undermine the long term *financial health of their franchisees* by diminishing their margins with excessive discounting. Most of the top brands understand the correct balance between these two extremes. However, there are two dangers that an unbalanced approach presents to a franchisor. The first is obvious: demoralization and financial undermining of franchisees through promotional destruction of their operating margins. The second issue is more subtle. Companies reporting that their sales are "good or improving" when in fact meaningful margin deterioration is undermining franchisee financial health may be unwittingly misleading constituents. Trading *margin* for *traffic* is a very serious endeavor which must be carefully studied by franchisors and planned in conjunction with franchisees in order to assure the best short and long-term outcome for the brand at large. The obvious answer on the reporting front is to present management discussion and analysis ("MD&A") findings on the impact of promotions or discounting on unit level or franchisee margins.

Last year we heard a lot of discussion about green shoots and we witnessed a remarkable comeback in the equity markets, particularly large cap companies. Recently, there has been a lot of discussion about this being the *summer of recovery*. We are eager for economic recovery, but we look at data, particularly unemployment, residential and commercial real estate, regional bank performance and federal and state budgets. The preponderance of evidence is that there is no meaningful improvement in key economic data which would lead one to conclude we are entering a recovery. The fact is that Knapp Track has been negative in traffic for the past 26 consecutive months. That says a lot. We're sympathetic with the administration's need to balance a positive spin in economic leadership with leveling with the American people. However, in a stricter SEC reporting environment, we believe that it may make sense for public companies to err on the side of over disclosure with respect to price and traffic components of same-store sales as well as some sort of proxy for franchisee margin performance.

Contributing Editor Kevin T. Burke is the Founder of and Managing Director for Trinity Capital.

A Note on the Proposed Capex Tax Credit

Last week, the President proposed a \$180 billion plan that includes a tax write-off for all business capital purchases in 2011. If enacted, this legislation will be great for some restaurant companies and devastating to others.

In 2003, Bush allowed businesses to expense 50% of capital spending in a single tax year as part of his tax incentive program. Obama is similarly proposing that 100% of 2011 expenditures are allowed to be expensed in a single tax year. Without this incentive, businesses have to wait between 3 and 20 years to get the full benefit of depreciating those types of expenses.

For companies armed with the cash necessary to load up on remodels, new builds, POS and other capital intensive initiatives in 2011, the incentive could provide significant tax savings. That tax benefit should be accompanied by the positive results of capital investment in the restaurant industry: a growing customer base and increase in market share.

However, the perversion of this type of legislation in the current static sales environment is that struggling restaurant concepts without the resources to keep up with the capital investments of their competition will lose traffic.

Obviously, capital investment in the restaurant industry is a significant determining factor of market share. In fact, behind consumer spending, the topic of initiatives to promote remodel and other capital expenditure is perhaps the single greatest strategic issue among restaurant companies. This is obviously a dynamic that exists in many industries and one that is getting a lot of attention in Washington. Legislators have gotten wind of the ~\$2 trillion of retained earnings at large companies who are hoarding cash out of fear and uncertainty. The Administration wants to offer incentives to those companies so that their hoarded cash might bolster the flailing economy.

There is little debate that capital investment can be a positive growth driver for businesses that depend heavily on consumer appeal to drive market share. This

is why, even without a tax credit, that capital is likely to be spent by competitive, strong companies trying to take market share. So, while the program will certainly assist healthy companies accomplish their strategic goals more quickly, companies with the most need for capital investment (and therefore the most vulnerable employees) do not pay taxes, do not have cash reserves and do not have access to willing capital partners.

Therefore, this proposal could compel an acceleration of corporate Darwinism. As long as the pool of consumer dollars allocated to restaurants continues to stagnate or decline, this policy will simply transfer customer traffic among industry players at an accelerated rate. It is an opportunity for healthy brands to grow market share by taking advantage of their wounded competitors. This is why, in a time of severe financial distress among some hamburger concepts, the average unit volumes at McDonalds have swollen to the levels of many casual dining concepts with much larger footprints. That's great for McDonalds, but after what has now become years of declining store level economics, this legislation, therefore could actually be the death nail to weaker concepts, and net jobs will be lost.

While the macro benefit of this kind of stimulus is a good thing for the economy, its effect is not going to be immediate or a single solution to our struggling economy. This kind of policy will only be embraced by healthy, performing companies who will utilize the incentive in order to effectively step on the neck of their competition. In other words, as it relates to restaurants where many companies have NOLs and negative net incomes, this legislation will not likely spur true industry-wide growth or generate net-new jobs until the reversal of the current consumer spending stagnation. In the mean-time, while we may celebrate the Administration's policy reversal toward tax incentives and away from check-writing, we have to understand that the result may be struggling companies ultimately become even more disadvantaged than they are today.

Contributing Editor Chad Spaulding is a Managing Director for Trinity Capital.

Trinity Capital is an active participant, sponsor and speaker at numerous industry conferences. Upcoming events include:

November 2010 - Trinity Capital is a conference sponsor and exhibitor at the 21st Annual Restaurant Finance and Development Conference in Las Vegas, November 8-10, 2010. Please stop by and visit us at our booth. Kevin Burke will moderate a panel discussing on the current state of the M & A marketplace for restaurants. Panelists will discuss valuations, how deals are being financed and structured, and will provide tips for concluding a successful transaction. If you are attending and would like to make arrangements for an on-site meeting please call Jennifer Brown at 310.231.3113 to schedule a time.