



What's Inside This Commentary

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Same-Store Sales Discussion and Analysis

Restaurant sales continued to decline in the third quarter of 2009 despite extensive use of couponing, trading down from higher price point dining, extensive promotional activity and a number of new or continued product introductions (Grilled Chicken at KFC, McCafe at McDonald's, Wing Street at Pizza Hut, etc.). In fine dining, all four of the companies we track were down by an average of (19.4%) for the third quarter of 2009. Both corporate and high-end users cutback materially on occasions in the fine dining category again in the third quarter of 2009. In casual dining, 26 of the 30 concepts that we track were negative for the third quarter with the segment down by an average of (6.6%). It was the fourth time in the last seven quarters in which there was an increase in the number of casual dining concepts that reported negative same-store sales. Five of the seven family dining concepts we track were also negative during the quarter with the segment down by an average of (4.2%). The fast casual segment ended the quarter with the best performance in the restaurant industry. The segment was flat for the third quarter, with four of the eight concepts we track reporting same-store sales declines.

In the QSR segment, 17 of the 22 concepts we track were negative during the third quarter of 2009 with the segment down by an average of (3.4%). This fact is perhaps the most disturbing because the QSR segment has been the biggest

beneficiary of trading down, discount limited time offers ("LTOs"), couponing, value menus and extensive promotional campaigns and new product introductions. If the executives in this sector had not acted as swiftly and aggressively as they did, we believe traffic in this sector would have been off by approximately 6% to 8%.

The big story, however, has been the margin improvement. Most of the gross profit margin improvement in the third quarter has come from either steady or modestly declining prices in beef, wheat, corn, pork and, to a lesser extent, chicken and gasoline. While prices for many of these commodities are up sharply from their November 2008 bottom, most concepts reflected either steady or declining costs of goods sold due to commodity price movements. Between significant G&A cuts and margin improvement, the industry generally posted reasonable earnings results given the significant decline in traffic for most concepts.

Finally, in our outlook for 2010 we believe that it will be like Dickens' *Tale of Two Cities*: concepts that prepare for the new lower traffic environment and make both substantial and subtle changes to negotiate this difficult environment will survive or even flourish. Concepts that continue some of the old management practices will suffer declining fortunes. Waiting for the economy to bail out same-store sales performance is a strategy that we believe will lead to failure in 2010.

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Same-Store Sales ("SSS") Data

| | <u>Q1 08</u> | <u>Q2 08</u> | <u>Q3 08</u> | <u>Q4 08</u> | <u>Q1 09</u> | <u>Q2 09</u> | <u>Q3 09</u> |
|--|--------------|--------------|--------------|---------------|---------------|---------------|---------------|
| Fine Dining: | | | | | | | |
| Fleming's | -6.8% | -8.4% | -9.7% | -20.8% | -19.9% | -22.4% | -18.0% |
| McCormick & Schmick's | -5.8% | -4.9% | -5.5% | -13.5% | -13.9% | -17.3% | -18.8% |
| Morton's Rest. Group | 0.7% | -1.9% | -7.6% | -12.0% | -24.1% | -26.1% | -16.8% |
| Ruth's Chris | -6.9% | -7.1% | -6.9% | -18.5% | -18.5% | -23.4% | -24.0% |
| Mean | -4.7% | -5.6% | -7.4% | -16.2% | -19.1% | -22.3% | -19.4% |
| Same Store Negative Count¹ | 3 | 4 | 4 | 4 | 4 | 4 | 4 |

Casual Dining:

| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Applebee's | 0.5% | -1.7% | -3.1% | -4.6% | -3.0% | -4.3% | -6.5% |
| Benihana | -1.0% | -4.9% | -6.5% | -11.1% | -10.4% | -10.1% | -9.9% |
| Big Boy & Golden Corral | 0.0% | -0.2% | 0.4% | -0.1% | 1.1% | 4.6% | -2.4% |
| BJ's Restaurants | 0.0% | 0.6% | -1.0% | -0.7% | -0.1% | -1.3% | -1.6% |
| Bonefish | -3.9% | -8.0% | -10.2% | -11.5% | -10.0% | -8.2% | -5.8% |
| Buffalo Wild Wings | 2.8% | 5.7% | 3.8% | 3.2% | 6.1% | 3.4% | 1.5% |
| California Pizza Kitchen | 0.4% | 1.4% | -2.4% | -7.2% | -5.9% | -6.5% | -8.0% |
| Carrabba's Italian Grill | 0.7% | -5.0% | -5.7% | -6.5% | -7.3% | -5.9% | -7.5% |
| CEC Entertainment | 3.6% | 5.7% | 1.1% | -1.5% | -0.1% | -5.4% | -3.1% |
| Cheesecake Factory | -1.8% | -4.1% | -4.7% | -7.0% | -3.2% | -3.0% | -2.4% |
| Chili's Grill & Bar | 1.6% | 3.4% | -3.0% | -4.2% | -5.2% | -9.4% | -6.0% |
| Dave & Buster's | 3.8% | 1.2% | -6.0% | -10.2% | -7.9% | -6.5% | - |
| Famous Dave's | 3.6% | 1.7% | -4.7% | -8.3% | -5.5% | -9.4% | -6.8% |
| Granite City | 1.8% | 0.5% | - | - | -11.2% | -13.2% | -12.7% |
| Landry's | 0.2% | -2.5% | -2.0% | -4.7% | -9.0% | -8.0% | -6.5% |
| LongHorn Steakhouse | -3.3% | -3.1% | -4.9% | -5.7% | -5.4% | -6.5% | -6.2% |
| Macaroni Grill | -3.2% | 5.7% | -9.0% | -10.6% | - | - | - |
| Maggiano's | -0.4% | -0.5% | -3.3% | -6.9% | -9.5% | -9.2% | -6.6% |
| O'Charley's | -4.7% | -1.4% | -4.0% | -6.1% | -2.9% | -6.9% | -7.6% |
| Olive Garden | 5.7% | 5.8% | 2.4% | 0.8% | -1.4% | -0.6% | -2.9% |
| On The Border | -1.8% | -2.3% | -3.3% | -3.7% | -5.0% | -5.8% | -5.1% |
| Outback | -2.6% | -5.3% | -7.9% | -9.1% | -8.4% | -10.2% | -10.7% |
| PF Chang's Bistro | 0.1% | -2.3% | -3.1% | -7.1% | -6.6% | -6.8% | -8.5% |
| Real Mex | -0.2% | 1.4% | -3.7% | -6.5% | -9.1% | - | - |
| Red Lobster | -2.0% | -0.2% | -3.7% | 0.3% | -4.6% | -0.6% | -7.9% |
| Red Robin | 4.0% | -0.8% | -2.4% | -6.7% | -7.8% | -11.1% | -14.8% |
| Ruby Tuesday | -12.7% | -10.3% | -10.8% | -10.8% | -6.8% | -3.2% | -3.1% |
| Stoney River | -3.2% | 6.4% | -8.1% | -18.2% | -17.2% | -20.4% | -17.1% |
| Taco Cabana | 0.7% | -0.6% | -0.9% | 0.5% | -1.6% | -3.8% | -4.3% |
| Texas Roadhouse | -1.2% | -0.3% | -3.2% | -4.9% | -1.4% | -3.7% | -4.4% |
| Mean | -0.4% | -0.5% | -3.8% | -5.8% | -5.5% | -6.1% | -6.6% |
| Same Store Negative Count¹ | 12 | 18 | 22 | 22 | 24 | 24 | 25 |

Family Dining:

| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Bob Evans | 1.7% | 2.0% | -2.5% | -1.3% | -1.6% | -3.0% | -2.8% |
| Cracker Barrel | 1.1% | -0.8% | -3.2% | -1.5% | -0.9% | -1.4% | 0.6% |
| Denny's | -0.4% | -2.8% | -5.1% | -6.1% | -1.1% | -4.2% | -7.2% |
| IHOP | 3.7% | 2.6% | 0.2% | -1.0% | 2.0% | -0.6% | -1.1% |
| Luby's | -3.3% | -2.0% | -6.7% | -3.2% | -8.9% | -13.6% | - |
| Ninety Nine | -2.2% | -3.1% | -8.1% | -8.4% | -4.5% | -10.0% | -7.1% |
| Perkins | -1.7% | -1.9% | -3.7% | -3.9% | -4.9% | -8.3% | -7.5% |
| Mean | -0.2% | -0.9% | -4.2% | -3.6% | -2.8% | -5.9% | -4.2% |
| Same Store Negative Count¹ | 3 | 4 | 5 | 6 | 5 | 6 | 5 |

¹ For purposes of comparison, excludes concepts that do not have SSS data for all 7 quarters

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

SSS Data (Con't)

| | <u>Q1 08</u> | <u>Q2 08</u> | <u>Q3 08</u> | <u>Q4 08</u> | <u>Q1 09</u> | <u>Q2 09</u> | <u>Q3 09</u> |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Fast Casual: | | | | | | | |
| Chipotle | 10.0% | 7.1% | 3.1% | 3.5% | 2.2% | 1.7% | 2.7% |
| Cosi | 0.3% | 2.2% | -0.1% | -6.9% | -11.3% | -12.2% | -10.7% |
| Einstein Noah Bagel | 3.6% | 1.0% | -1.7% | -3.3% | -5.7% | -2.2% | -3.1% |
| Panera Bread | 2.4% | 5.5% | 3.3% | 2.7% | 0.7% | -0.4% | 2.8% |
| Qdoba Mexican Grill | 2.4% | 0.5% | -1.0% | -1.1% | -2.3% | -2.8% | -3.1% |
| Rubio's Restaurants | -3.3% | -3.9% | -2.1% | -0.2% | 1.9% | 0.9% | -2.7% |
| Steak n Shake | -6.3% | -5.8% | -7.4% | -1.4% | 2.4% | 5.0% | 10.1% |
| Tim Horton's (US) | 1.0% | 3.1% | -0.6% | -0.1% | 3.2% | 3.3% | 4.3% |
| Mean | 1.3% | 1.2% | -0.8% | -0.9% | -1.1% | -0.8% | 0.0% |
| Same Store Negative Count¹ | 2 | 2 | 6 | 6 | 3 | 4 | 4 |

QSR:

Chicken:

| | | | | | | | |
|--|--------------|-------------|--------------|--------------|--------------|--------------|--------------|
| Church's | 2.4% | 3.3% | 4.0% | 2.1% | 1.5% | -5.6% | - |
| El Pollo Loco | 1.8% | 1.9% | 0.0% | -2.5% | -5.9% | -6.8% | -10.1% |
| KFC | -2.0% | -3.0% | -6.0% | -3.0% | -7.0% | 3.0% | -2.0% |
| Pollo Tropical | -1.0% | 0.1% | -1.9% | -3.6% | -3.0% | -3.1% | -0.1% |
| Popeyes | -1.8% | -1.7% | -2.8% | -2.8% | -0.3% | 4.3% | -0.3% |
| Mean | -0.1% | 0.1% | -1.3% | -2.0% | -2.9% | -1.6% | -3.1% |
| Same Store Negative Count¹ | 3 | 2 | 3 | 4 | 4 | 2 | 4 |

Coffee/Snack:

| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Caribou Coffee | -2.3% | -1.7% | -4.7% | -5.1% | -5.0% | -3.3% | -0.5% |
| Jamba Juice | -4.2% | -7.3% | -10.3% | -12.0% | -13.8% | -13.7% | -5.3% |
| Krispy Kreme | -3.9% | -9.2% | -11.8% | -1.9% | 2.1% | 5.9% | - |
| Starbucks | -5.0% | -5.0% | -8.0% | -10.0% | -8.0% | -6.0% | -1.0% |
| Mean | -3.9% | -5.8% | -8.7% | -6.3% | -6.2% | -4.3% | -2.3% |
| Same Store Negative Count¹ | 3 | 3 | 3 | 3 | 3 | 3 | 3 |

Mexican:

| | | | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Taco Bell | 7.5% | 7.3% | 9.0% | 9.0% | 2.0% | 1.0% | -2.0% |
| Mean | 7.5% | 7.3% | 9.0% | 9.0% | 2.0% | 1.0% | -2.0% |
| Same Store Negative Count¹ | 0 | 0 | 0 | 0 | 0 | 0 | 1 |

Pizza:

| | | | | | | | |
|--|--------------|-------------|--------------|--------------|--------------|--------------|--------------|
| Domino's | -5.2% | -5.4% | -6.1% | -3.0% | 1.0% | -0.7% | 0.0% |
| Papa John's | 1.7% | 2.4% | 1.7% | -2.0% | 0.3% | 0.1% | 0.0% |
| Pizza Hut | 2.0% | 5.0% | 5.0% | -1.0% | -3.0% | -8.0% | -13.0% |
| Sbarro | 0.3% | 0.0% | -1.0% | -8.0% | -4.8% | -5.1% | -5.2% |
| Mean | -0.3% | 0.5% | -0.1% | -3.5% | -1.6% | -3.4% | -4.6% |
| Same Store Negative Count¹ | 1 | 1 | 2 | 4 | 2 | 3 | 2 |

Sandwich:

| | | | | | | | |
|--|-------------|-------------|-------------|-------------|--------------|--------------|--------------|
| Arby's | 0.4% | -3.3% | -5.0% | -8.5% | -8.7% | -6.9% | -9.0% |
| Burger King | 5.6% | 5.6% | 3.0% | 1.7% | 1.6% | -4.5% | -4.6% |
| Carl's Jr. | 3.9% | 3.8% | 0.5% | -0.6% | -5.1% | -6.1% | -5.2% |
| Hardee's | -0.6% | 3.3% | 1.3% | 1.5% | 2.5% | -2.7% | -1.8% |
| Jack in the Box | -0.1% | -0.4% | -0.8% | 1.7% | 0.4% | -1.0% | -6.0% |
| McDonald's | 2.9% | 3.4% | 4.7% | 5.0% | 4.7% | 3.5% | 2.5% |
| Sonic Drive-In | 3.2% | -0.4% | -0.6% | -3.6% | -3.6% | -5.4% | -4.5% |
| Wendy's | -1.6% | 0.9% | 0.1% | 3.7% | 1.0% | -0.4% | -0.1% |
| Mean | 1.7% | 1.6% | 0.4% | 0.1% | -0.9% | -2.9% | -3.6% |
| Same Store Negative Count¹ | 3 | 3 | 3 | 3 | 3 | 7 | 7 |

| | | | | | | | |
|--|-------------|-------------|--------------|--------------|--------------|--------------|--------------|
| Mean Total QSR | 0.2% | 0.0% | -1.4% | -1.8% | -2.3% | -2.8% | -3.4% |
| Same Store Negative Count - QSR¹ | 10 | 9 | 11 | 14 | 12 | 15 | 17 |

¹ For purposes of comparison, excludes concepts that do not have SSS data for all 7 quarters

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

Continued Impact of the Credit Crisis of 2008

One of the lingering issues from the inception of the credit crisis of 2008 has been the noticeable lack of meaningful activity in the structured finance market other than that propped up by the federal government (e.g. TARP, TALF, etc.). In 2007, the U.S. economy grew to approximately \$14 trillion versus the rest of the world's combined economies of \$37 trillion. This growth was aided by our robust structured finance market which served as a source of liquidity in the secondary market for banking loans, credit card receivables, auto loans and home equity loans. This market has been virtually dormant since July of 2008 other than with backing of the federal government. The government no longer has liquidity to sustain this market as it did last year. As a case in point, the Federal Reserve bought most of the new treasury bonds/notes/bills offered during 2009.

We believe that with \$2 trillion in structured finance missing from the market, it will be hard to imagine overall restaurant traffic making any meaningful improvements during 2010. That is not to say that certain concepts will not perform well, particularly the well capitalized market share leaders who tend to be strategically minded. We firmly believe that while there may be a bounce in near-term Gross Domestic Product ("GDP") and employment numbers, the economy's long-term prospects will not improve until there is a meaningful sustained improvement in employment, housing, commercial real estate and regional banking.

One of today's big challenges in reading the economic tea leaves is the prolonged period of negative data and resulting statistical anomalies in conventional economic indicators. For instance, when comparing two negatives such as -6% in 2008 and -4% in 2009, do you say there has been a 33% improvement? Another issue has been many of the subtle adjustments that the Department of Labor, Department of Commerce, Bureau of Economic Analysis and other reporting agencies

use with their data. While it is almost always good for directional guidance, you have to read very carefully between the lines for some of the key numbers particularly those of employment and inflation.

Navigating the Current Economy

The U.S. economy continues to face unprecedented economic challenges. Following six consecutive years of expansion (18 years excluding the internet bubble burst), the pace of real GDP growth turned negative in the second half of 2008. Q4 2008 and Q1 2009 represented the first time since the Great Depression that the economy contracted more than five percent two quarters in a row. Since reaching a peak in July 2007, the Conference Board Leading Economic Index^(TM) ("LEI") for the U.S. fell for twenty consecutive months, the longest downtrend since the mid 1970s. Market analysts and the media have all offered strong opinions and are resigned to the notion that this economy has been the worst in 70 years.

Recently, however, we have been bombarded with press releases suggesting that leading economic indicators are signaling the recession may be over as soon as today, not three to six months from now. Fed Chairman Ben Bernanke and U.S. central bank officials, some private-sector economists and members of the current administration are all crowing that the economic news is indicating a near-term turning point. They are sounding so convincing that the recession will end soon that even we catch ourselves "drinking the Kool-Aid." But our position is that nominal GDP growth is not the correct measure of progress. We believe that housing, commercial real estate, employment and regional bank health are the correct measures for recovery.

Economic Indicators

Our perspective on economic recovery is based on extensive review of both leading and lagging economic indicators as well as those noted above.

We believe those who suggest there are strong signs of economic recovery are searching for and clinging to any data offering a glimmer of hope. Believe us when we say that we want them to be correct. However, fueling their argument, in part, are recent LEI results, which rose in September for the sixth consecutive month. Eight of the ten indicators in the September report contributed positively to the index reading while two indicators subtracted from it. In these six consecutive positive months, an average of six of the indicators contributed positively to the index reading while an average of three subtracted from it (*an average of one of the indicators has been flat*). Discerning whether the index reading allows one to conclude that we have turned the corner on this recession is actually very difficult. The recent numbers seem to suggest that a recovery is developing. However, the speed of that recovery depends on how much, and how soon, demand picks up. In any case, the intensity and pattern of that recovery is uncertain, and the economy is wreaking unprecedented havoc on restaurant sales and traffic.

The positive indicators that have led pundits to express enthusiasm about a potential recovery provide evidence to economists that government efforts have eased the financial turmoil and economic recovery has materialized. Again, we await recovery in employment, real estate and banking sectors.

For example, the biggest boost to a positive index reading has been the widening spread between the short-term treasury bills and 10 and 30-year Treasury bonds (*the steepening slope of the yield curve*). However, the increase at the long end of the yield curve may have come by way of mounting speculation of an economic recovery, the difficulty in selling long Treasury bonds in this environment and the government stepping in to purchase Treasuries to stabilize the U.S. Treasury market.

Jobless claims may be decreasing, but each recently announced monthly unemployment rate seems to trump the prior 26-year high. Fifteen

states are now reporting double-digit unemployment, and aggregate state budget deficits are a problem for economic recovery.

Companies reporting better-than-expected third-quarter earnings results have been providing some good news for the equity markets. However, nearly 40 percent of favorable earnings were due to aggressive budget slashing and cost cutting which offset declines in revenue. Cutting costs can only be implemented to a certain point before it becomes degenerative to operations and cannot be relied upon to continuously sustain positive earnings results in the long run. In 2010, companies will need to show sales increases to mollify equity analysts.

Housing starts were down in September, however, any increases over the last six months is just like restaurant reporting; abysmal same-store sales in a prior year will eventually lead to positive comps the next year. Consider that housing starts fell over 90 percent from their peak in 2007. Therefore, a five percent increase from those levels does not warrant over-enthusiasm.

Factory workweek hours were a positive contribution to the index, but the details are not persuasive. Manufacturing workweek hours for June only slightly increased, from 39.4 hours to 39.5 hours, and was actually down from 40.8 hours in June 2008. Employment needs to grow to boost transaction count in the industry.

More telling is that the three components of the index which detracted from the reading were the M2 money supply (*bank loans*) which decreased, manufacturing orders which decreased and speed of delivery of merchandise from vendors to suppliers which increased (*meaning there is more capacity in the distribution system to allow for more speedy deliveries*). All tolled, it seems to us that the signals of a turnaround may not be strong enough to draw any meaningful conclusion.

As far as financial turmoil waning, some economists may sense that the government's aggressive intervention was "mission accomplished" for the time being. We believe that economic data suggests another wave of economic pressure is unavoidable. A study of the trends in the economic indicators, particularly those which the restaurant industry is most sensitive to, suggest that the economy and restaurant performance will remain weak through 2010 and here's why:

Consumer Spending

Consumer spending is the number one barometer restaurant operators look to for a pulse of the economy. The growth or contraction of our economy is measured in terms of the size of GDP. Consumer spending has dramatically increased as a percent of GDP, primarily driven by the proliferation of consumer debt as Americans took equity from their homes that inflated in value over a relatively short period of time or tapped credit cards to the tune of several trillion dollars. But spending of this magnitude is not sustainable. Consumer spending is a function of several influential components, the largest of which is employment. With federal unemployment hitting 10 percent in 2009, the elimination of jobs in and of itself may continue to mount pressure on people spending money that is not there to spend. Every 100,000 payroll jobs lost eliminates \$3 billion in disposable income. Over 7.2 million jobs have been lost through this recession. Lost jobs mean more defaults on debt. In 1981, U.S. private debt was 123 percent of GDP; by the third quarter of 2008, it was 290 percent. This unprecedented level of consumer debt has led to record credit card delinquencies. Over the past year alone, delinquency rates on single-family residential mortgages have also more than doubled. High delinquency rates, in the face of increasing unemployment, means that credit cards do not get repaid, eliminating capacity to spend and making credit less available to consumers. Without available credit extended, consumers will likely pull

back their spending and begin to save or retire debt.

Consumer spending has also been negatively impacted as American's net wealth significantly deteriorated. Approximately \$30 trillion of market value from stocks, bonds and real estate was lost worldwide in 2008; about half of it in the U.S. alone. The personal savings rate has recently increased from an all-time 40 year low, meaning, consumer spending may be right sizing relative to the massive declines in real wealth. The bottom line is that the continuing economic uncertainty and household hardships may have resulted in significant changes in consumers' spending behavior. The consumer is nervous and is more likely to save than spend in the current environment. Consumers tend to respond with long and variable lags to changes in wealth and income. Until we start to see more convincing signs of stability in employment, home values, savings rates, and bank credit, meaningful economic recovery may elude us.

Fast food sales, usually robust in a recession, has fallen approximately 2 percent from this time last year and has been negative seven of the last nine months. While we remain surprised that many brands are holding up as well as reported, we believe operators and brands continue to be exposed to significant risks. We fear that the magnitude of these risks and how they may directly impact restaurant businesses may be underestimated. Interestingly enough, with the backdrop of the credit crisis, certain factors may have actually been benefitting restaurant operators through 2009. However, we believe that these benefitting factors present certain risks to restaurant operators going forward.

Rising Food Costs

Food costs represent about a third of a restaurant's operating expenses and an increase in commodity prices to record highs in 2008 made a significant impact on the industry's profitability. Through 2008, the U.S. was wrestling with the worst food

inflation in 18 years subjecting operators to sharply higher costs for grains, meats and dairy. A weakening U.S. dollar has made commodities cheaper for foreign buyers, further lowering their supply to U.S. buyers. Commodity prices coming off their all-time highs in 2008 have been recently providing restaurant operators some reprieve by easing pressures on food margins. We anticipate food costs may increase, as the U.S. dollar may continue to weaken and inflation pressures from the government spending spree may take root. Cost increases cannot be easily passed onto consumers and may present additional risks that can impact the cost of sales and hence cash flow.

Consumers Trading Down and Limited Time Offers

Brands have been vying for market share with the re-introduction of aggressive LTOs. This trend is pervasive across the industry and predominantly adds undue pressure on margins, thereby reducing cash flow. It seems that as brands compete for market share, they continue to up the ante by offering even more enticing margin-eating value deals. Rising commodity costs in the face of brand's attempts to drive traffic at the expense of aggressive value LTOs may exacerbate pressure on food costs and profitability. The downward pressure on operating margins may actually outweigh the benefit of attempting to drive traffic to the stores. For many brands, LTOs are not sustainable because they may not be able to absorb the increased food costs for extended periods of time. In this competitive environment when aggressive and long-standing value LTOs may no longer be sustained by a particular brand, traffic count and sales may wane as competitor value propositions become more attractive.

Artificially Low Interest Rates

As of the beginning of 2009, the fixed income market, in particular Treasury securities, has been driven up as the demand for safe, liquid assets has been so great that at times market participants have pushed the yield on some near-term Treasury securities to zero. The Federal Open Market Committee has also played a key role in keeping

the effective fed funds target rate essentially at zero. This has resulted in extremely favorable interest rate conditions for restaurant operators because a significant portion of their debt is variable rate indexed, for the time being, to the artificially low Prime Rate, a Treasury index or the London Inter-Bank Offer Rate ("LIBOR"). However, interest rates cannot stay at these levels in the long run, particularly in the light of the government's enormous ongoing structural budget deficit. Ultimately, this will drive rates up to attract investors.

Rising Energy Costs

Oil prices nearly tripled from \$50 to \$140, pushing gasoline prices to an all-time high from late 2007 to July 2008, diminishing the number of cars on the road, reducing traffic and consumers' opportunity for dining away from home. Gasoline prices have since come down and experts believe that increasing global economic development (*primarily in Asia*), expectations of an economic recovery and a future rebound in oil demand, continued production restraint by members of OPEC and unrest in Iran and Nigeria may continue to put upward price pressure on oil through 2010. The recent reprieve from higher energy costs may have actually helped restaurants, but anticipated increases may again reduce the number of cars on the road and hence restaurant traffic count.

Sustaining the Economy

The Federal government's attempts to sustain a \$14 trillion economy cannot continue without implications on inflation, the dollar and the deficit. In order to finance the enormous 2009 and 2010 budget deficits and the expensive stimulus, bailout and social programs, the Federal government is planning a 15-fold increase in the U.S. monetary supply and the enormous issuance and sale of approximately \$3.5 trillion of gross issuance of U.S. Treasury notes in the 2009 fiscal year alone. Such actions would typically result in a staggering devaluation effect on the dollar, which may in turn present inflationary pressures that may cause interest rates and commodity prices to increase.

Therefore, the recent reprieve from which restaurant operators may have benefitted, such as: artificially low interest rates; gasoline and food prices coming off all-time highs; aggressive value LTOs driving traffic to stores; and consumers trading down will likely wane. In fact, these factors may become looming liabilities to restaurant operators in 2010.

Risks Facing Restaurant Operators

We believe interest rates always regress to their average. A reversion from the current 30-day LIBOR rate of .23 percent (*LIBOR was 2.46 percent one year ago*) to its historical 20-year mean of approximately 4.45 percent is, at best, troublesome. An increase in LIBOR to its historic 20-year average would increase the effective interest rate to 6.70 percent. Consider that 30-day LIBOR was at 5.01 percent as recently as December 2007. This potential reversion confronts restaurant operators with a serious cash flow demand. Operators facing these additional challenges without any significant offset in performance may end up in technical default with their lenders, or worse, monetary default. Lending institutions are aggressively enforcing loan provisions to charge the default rate of interest, re-pricing loans or unfavorably modifying loan terms. Ultimately, if a resolution with a lender is not achieved, one of the paths lenders may take is to invoke acceleration clauses mandating immediate payment of the entire loan balance, plus any onerous prepayment penalties, loan modification fees and legal fees. This can certainly leave operators in an unnerving situation, particularly given the current limited options in accessing financing. While this is somewhat predatory given the current environment, it is nonetheless happening.

Aside from increasing interest rates, many restaurant operators may soon be required to refinance their maturing loan obligations. Operators that entered into relationships with any one of the leading restaurant finance lenders in the late 1990's were provided fixed rate loans with 10

or 15 year maturities, or variable rate loans in the early 2000's with 7 to 10 year maturities. Many of these loans have much longer amortizations (*anywhere from 10 to 25 years*), presenting borrowers with significant balloon or refinancing risk. Since the majority of the monthly loan payment for a typical 25-year amortizing mortgage is applied to pay interest for approximately the first 15 years, only 25 percent of the principal amount is paid down after 10 years. That means if a loan matures in 10 years, a restaurant operator may need to refinance 75 percent of the original loan amount. In the wake of the credit crisis, lenders have employed much more stringent credit standards. Where lenders were once providing 3.5x to 5x leverage five to seven years ago, they are now hard pressed to lend up to 3x times cash flow. The opportunity for operators to successfully refinance their debt obligations may be compromised unless they are able to contribute a significant amount of additional equity or restructure their obligations.

Restaurant franchisees that may need to access their equity to contribute toward refinancing shortfalls or to meet working capital needs may also need that same capital to complete their franchisor obligated capital expenditures ("capex"). The continuing and meaningful obligations franchisees face in keeping up with current imaging requirements is demanding. These obligations must be financed either from cash flow, owners' equity or by a third party. However, funding for capex in the current economic environment has proved to be among the more serious risks franchisees face. Equity, investments and savings may have been materially reduced and tapping debt capital from restaurant lenders is difficult.

As operators potentially face the confluence of one or more of these risks coming to fruition, access to capital will be of paramount importance. However, the credit crisis has effectively changed the landscape of restaurant lenders. The mass exodus of lenders in the wake of the credit crisis has removed a tremendous amount of lending capacity

from the market. Furthermore, some restaurant lenders are so immersed in managing their loan portfolios, contending with increasing defaults, high brand concentration exposures and bringing solutions to de-leverage, that getting their attention to refinance or modify loan obligations can be a challenge. We anticipate there will be an unprecedented need for debt financing by restaurant operators as they look to the debt markets to survive and meet their working capital needs, capex and new equipment requirements, finance growth opportunities and refinance maturing debt obligations. In an environment where the number of available financing alternatives has been sharply reduced and the demand for new financing may be so great, this disparity may perhaps become the greatest risk that restaurant operators will face in 2010 and beyond.

What Steps Should Restaurant Operators Take?

We believe it is critical at this juncture for restaurant operators to analyze their debt obligations, capital structure and evaluate their potential risk exposure. The results of this analysis, at the very least, will be an eye-opener for many restaurant executives. We also take note that, given the state of the economy and our perspective on what may transpire, now is the time to acquire a complete understanding of the on- and off-balance sheet obligations and working capital requirements.

Equally important is analyzing profit and loss statements in detail to look for additional ways to cut costs. This would extend beyond the obvious adjustments to labor, food and controllable expenses. It may be time to get creative to significantly lower costs without impacting operations. Approaching suppliers for concessions or approaching landlords for rent adjustments is generally more favorable to the vendor or landlord than losing a customer or vacating the space. More extreme and difficult decisions to make may include having to explore the sale and leaseback of real estate, reduction of overhead by cutting

administrative staff, or temporarily lowering compensation.

In combination with the effort related to clearly understanding opportunities within the profit and loss statements, forecasting, budgeting and planning are critical in today's environment. Whether restaurant operators forecast out of habit and discipline or have new requirements by outside parties, the uncertainty of the economy and consumer requires certain considerations. Forecasting a "rosie" financial position to appease creditors will do more harm than good. Creating solutions based on rising or flat sales in the next year may not be realistic. Solutions based on achievable numbers are the best recipe for success in these uncertain times.

We encourage restaurant operators to evaluate their debt and capex obligations to mitigate these exposures. We have helped companies review loan covenants and evaluate performance for tripping covenants. Trinity has worked with companies to ensure they have ways to meet their reimagining requirements, pay down debt or even exploit opportunities that may exist with their lenders. Trinity has also worked with companies exploring the sale and leaseback of real estate with a pro-forma analysis and review of tax implications to ensure that the decision is sound. For instance, after the payment of the 15 percent capital gains tax and 25 percent depreciation recapture tax, state income and transfer taxes, repayment of the loan, any associated prepayment penalties and other transaction costs, the net proceeds may not provide a restaurant operator with enough working capital to make the transaction economically prudent. A sale leaseback transaction may not make sense after the tax impact on exchanging debt service for rent expense (*only interest expense is tax deductible whereas 100 percent of the rent expense reduces net income, hence tax liability*). Last but not least, consider that real estate assets in the current lending environment offer the most valuable collateral lenders require to issue financing with the maximum advance rates at

the lowest cost of funds. Generally, lenders need tangible assets to come to the table with a restaurant loan.

If all of these strategies have not, or cannot be executed, a business restructuring may be the next step to explore. We have restructured over 400 different restaurant businesses. The one common denominator among all of these engagements was that many times the restaurant operators waited too long to anticipate, develop and implement a game plan to contend with the economic factors and financial risks discussed above or did not raise their hand early enough to get help.

Implementing a plan is very resource intensive and negotiating with landlords, lenders, other creditors and their respective legal counsel is extremely time consuming. It is common that restaurant operators facing a restructuring are already so inundated trying to meet the daily operating requirements, that the thought of negotiating with the countless counterparties in addition to what is normally required of them becomes overwhelming and is put off for another day.

Being proactive and candidly communicating with creditors regarding the current situation is the best strategy for a successful outcome. However, before stepping into this unfamiliar "bubble-gum", it is prudent for a restaurant operator to consult with a trusted advisor that has extensive experience and is proficient in working with restaurant operators, their lenders, their landlords and other creditors. The insertion of an impartial, emotionally unattached advisor that obtains a comprehensive understanding of the current financial situation, looming off-balance sheet obligations, loan obligations, lenders' rights and the strengths and weaknesses of the business, will provide a much higher likelihood that a successful plan can be implemented should one need to pursue this alternative. In executing any of the strategies described above, the ingredients which lead to the best outcome is to focus on operations and not spend time playing accounts payable shell games. Regardless of which direction the economy heads from here, the right recipe for success is to fully assess the situation, understand the risks, execute on one or more of the strategies discussed herein or ask for outside help before it is too late.