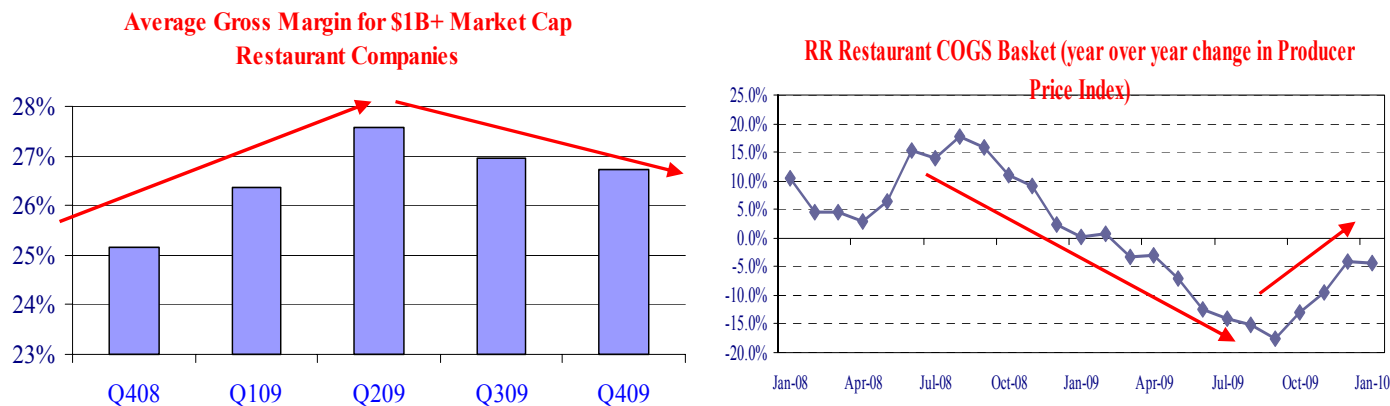


Restaurant Research Think Piece – February 2010

The Cost/Discounting/Traffic Conundrum

Unemployment gets worse throughout 2009 thus weakening restaurant traffic and sales while the average gross margin of \$1B+ market cap restaurant companies power higher though the second quarter. What gives? OK, it is not a huge secret... Food costs came down dramatically as economic weakness popped the 2008 commodity bubble.



Source: Restaurant Research LLC

Lower 2009 food prices did two things for industry players: (1) it fueled discounting that, in turn, drove higher traffic levels, and (2) it improved profits. We cringe to think what actual industry traffic levels would have been without such strong discounting. Notably, the fact that gross margins could ramp-up so strongly during 1H09 despite active discounting is a testimony to the degree of food deflation.

Now what? Food costs are starting to ramp-up again. We are not ready to concede that this is a function of strengthening economic growth as it is our opinion that this is actually driven by a reflatting commodity bubble fueled by the world's easiest monetary policy ever instituted.

In turn, lower gross margins suggest less room for discounting which can only mean less traffic in a jobless "recovery" with declining consumer confidence. Higher healthcare costs could really hurt here! In any case, we note that despite a declining trend, the industry's gross margin remains significantly higher during 4Q09 vs. 4Q08 – providing us some cushion for the time being.

For more information about how to gain access to RR's store level data - please contact us at (203) 405-1901 or info@ChainRestaurantData.com.

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Restaurant Research LLC leverages an extensive network of industry players as part of its annual Concept Benchmark Analysis due diligence process for 22 large US restaurant chains. Also, RR tracks store level data for all major chains with system-wide sales in excess of \$1B across all major restaurant segments in order to produce 11 key Industry Data Topic reports.

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