RESTAURANT INDUSTRY TRENDS AND RESTRUCTURING CONSIDERATIONS & PITFALLS

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WYNNCHURCH | CAPITAL

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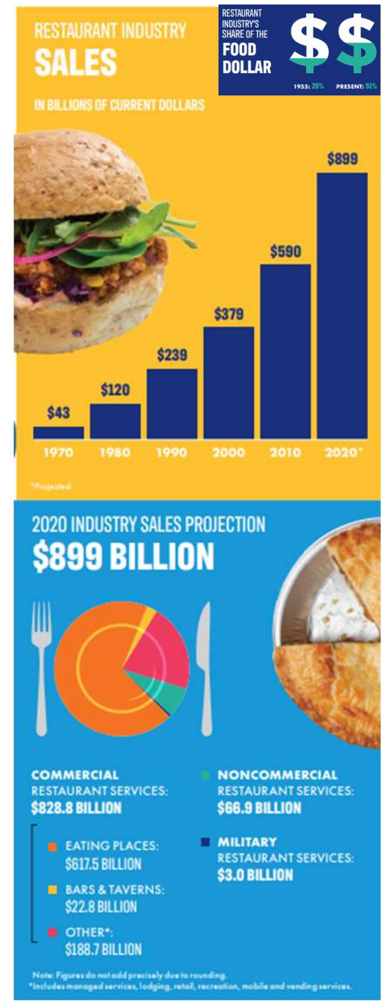
RESTAURANT INDUSTRY OVERVIEW

SNAPSHOT

- $899 billion: Restaurant industry's estimated sales in 2020.
  - Segmented into High-end, polished casual, casual, fast casual and QSR.
- 1 million+: Restaurant locations in the United States.
- 15.6 million: Restaurant industry employees.
- 1.6 million: New restaurant jobs created by 2030.
- 9 in 10 restaurant managers started in entry-level positions.
- 8 in 10 restaurant owners started their industry careers in entry-level positions.
- 9 in 10 restaurants have fewer than 50 employees.
- 7 in 10 restaurants are single-unit operations.
- 63% of consumers would rather spend on an experience than purchase an item.
- The number of middle-class jobs ($45K-$75K) in the restaurant industry grew 84% between 2010 and 2018, more than 3 times faster than in the overall economy.

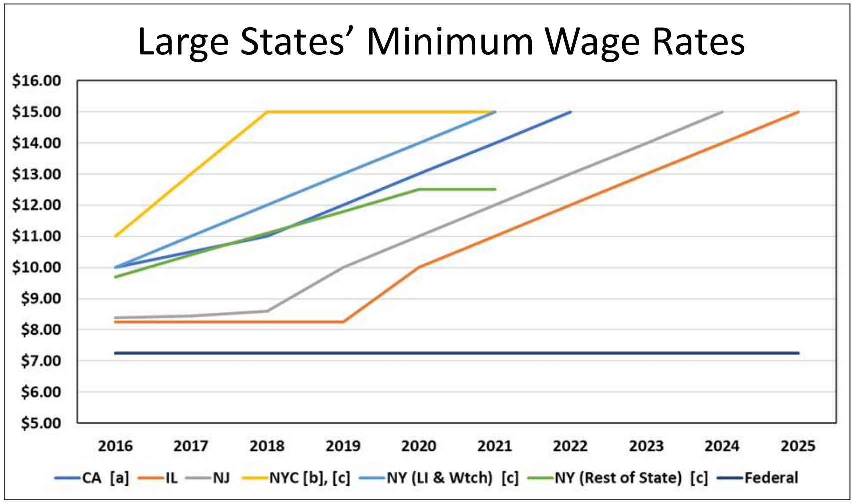
Source: National Restaurant Association.



RESTAURANT INDUSTRY OVERVIEW

TRENDS : PRE-COVID

- Rising Minimum Wage and Labor Turnover
  - Labor turnover (quality of service) has always been a problem and raising wage costs had become a critical issue.
- Competition is **fierce**!
- Distress was most pronounced in Casual Dining, Family Dining, Catering and Buffet/Cafeteria.
  - Each category has too many undifferentiated brands.



- Only the well-capitalized were making the needed investment in technology.
- Many restaurant chains have too many unprofitable restaurants.
  - Franchisors impede Franchisees from closing money-losing restaurants.
- Many restaurant footprints (square feet) are too large for efficient space utilization.
- Millennial behavior has driven up delivery/take-out at the expense of more profitable dine-in customers.
  - GrubHub, Uber Eats, Postmates, Caviar, etc. take approx. 25%-30% of the check but coming down.

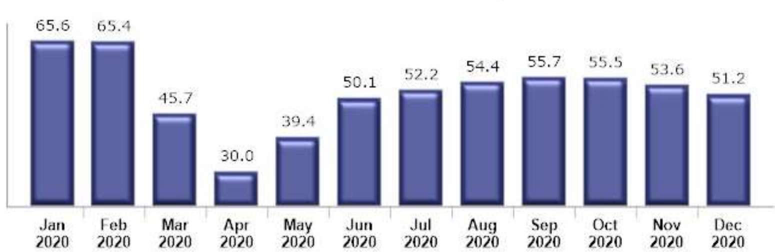
RESTAURANT INDUSTRY OVERVIEW

TRENDS : DURING-COVID

- Only the **well-capitalized** and **drive-thru** windows survive.
- Chapter 11/Chapter 7/Out-of-court restructurings.
- Tightening in credit markets but capital remains available for strong operators.
- Rising COVID cases beginning in Nov. 2020 have slowed the recovery.

Total Eating and Drinking Place Sales

(in billions of current dollars)

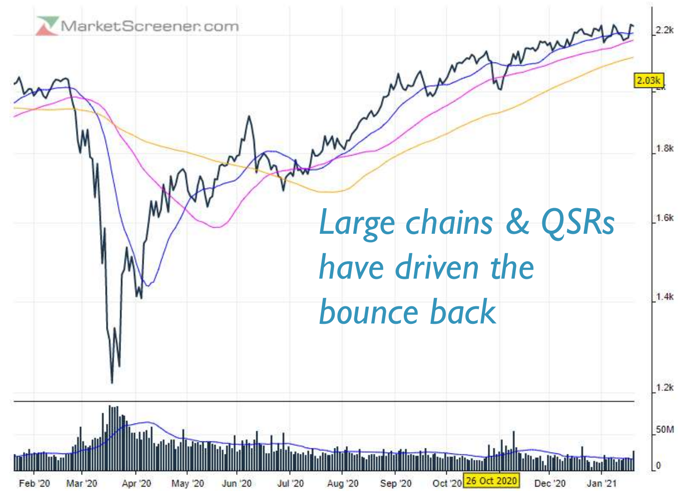


Source: U.S. Census Bureau; figures are seasonally-adjusted

- Accelerated growth in off-premise dining / mobile ordering.
- Added costs due to tracing requirements, cleaning supplies.
- Stream-lined menus.
- Liability from Employee and Customer exposure.

Dow Jones Restaurant & Bar Index

1/21/20 to 1/21/21



2020 Restaurant Chapter 11 Filings

Bar Louie	Il Mulino	Ruby Tuesday
Krystal	Garbanzo	Chuck E Cheese
Sweet Tomatoes	K&W Cafeterias	Le Pain Quotidien
California Pizza Kitchen	Maison Kayser	Village Inn / Baker's Square
Sizzler	Brio / Bravo	By Chloe
Friendly's	Le Pain Quotidien	Cosi
Numerous Franchisees		Logan's Roadhouse

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RESTAURANT INDUSTRY OVERVIEW

TRENDS : DURING-COVID (Cont.)

- Government-sponsored programs, much of it forgivable and/or with attractive terms, have provided a lifeline for many restaurant chains.
- 2020 - 1st Paycheck Protection Program ("PPP") provided up to $10 million per entity.
- 2021 - 2nd PPP Program provided up to $2 million per entity.
- 2021 – Employee Tax Credit can provide $ millions of additional funds/grants.
- 2021 – Restaurant Revitalization Fund ("RRF") can provide up to an additional $10 million but limited to smaller chains.
  - For restaurants established prior to 2019, the grant will equal 2019 revenues minus 2020 revenues.
  - $28.6 billion fund for direct grants for small chains (<20 locations) and independent restaurants.
  - Grants may cover such items as:
    - Payroll, benefits, mortgage, rent, utilities, outdoor seating construction, supplies, PPE, cleaning materials, food, operational expenses, and interest.
  - If a restaurant received a loan from 1st or 2nd PPP program, the amount of that loan is deducted from the Grant.

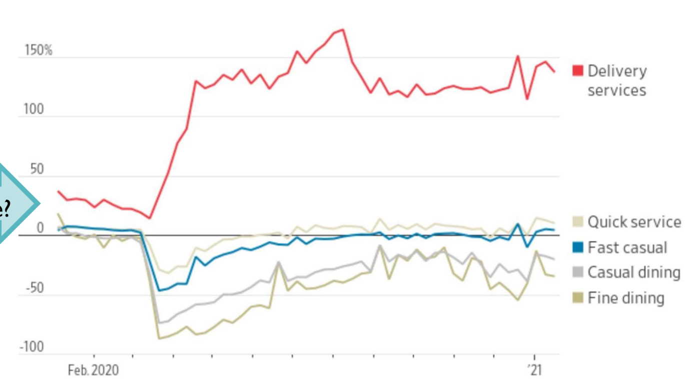
RESTAURANT INDUSTRY OVERVIEW

TRENDS : POST-COVID (1-2 Years)

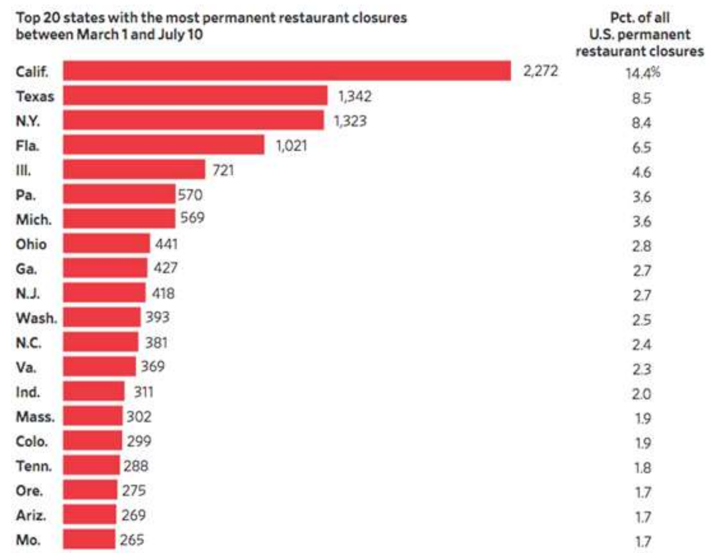
- **Gap between Strong and Weak Performers will widen.**
  - Strong brands, consumer loyalty and off-premise channel will lead the way.
- **Permanent Changes in Consumer Behavior**

Will this trend reverse?

  - Zoom, Peloton, On-line Conferences, Draft-Kings, etc. are cutting into business and leisure travel dine-in restaurant meals.
- **Stakeholders may need to fund losses until sales recover to a cash neutral position.**
- **Deferred Expenses and Maintenance Capex**
  - Deferred rent, vendors, sale taxes, etc.
- **New Operational Expenses Likely Remain**
  - New training, new cleaning materials, separators, etc.
- **Availability of Debt Financing and Equity Capital**
  - Banks and Non-Bank have and will face significant losses.
  - M&A and Lenders will be active in QSR but less interest in Fast Casual and Full-Service
- **Significant Permanent Restaurant Closures are Predicted**
  - Aaron Allen & Assoc. estimates one in three U.S. Restaurants will close permanently.



Source: Earnest Research



Source: Yelp

RESTAURANT INDUSTRY OVERVIEW

TRENDS : POST-COVID (3-5 Years)

- **Less Competition! (Maybe…..)**
  - Will Lead to higher store traffic, better capacity utilization.
- **Greater Investment Discipline**
  - Equity / Debt Capital will require higher returns and more rigor.
  - Fewer Independents and Owners who treat an investment in a bar or restaurant as a hobby.
- **Technological Innovation, Ghost Kitchens, Virtual Brands**
  - Kitchen automation, ordering kiosks, digital marketing, mobile ordering make barriers to entry higher.
- **Top Fast Casual and QSR will Increase Market Share.**
- **High-end/Polished Casual will "up" their Food Game and Provide an Experience.**

CONSULTANT'S PLAYBOOK, COMPLEXITIES AND PITFALLS

Consultants Playbook to Immediately Improve Financials Results

- Close negative cash flow **restaurants** immediately.
  - Challenge Management to make a case to keep it open.
  - Requires negotiations with Landlords and Franchisors.
- Renegotiate **leases** if lease costs exceed 8% of sales (6% should be target on good performing restaurants).
  - This is an opportune time as Landlords are willing to be flexible.
- Renegotiate contracts with major **vendors**.
- Must reduce **Parent G&A** to no more than 6% to 7% of sales, if not lower.
- Stream-line the **menu** and focus on higher margin items.
- Evaluate the pros & cons of Chapter 11. - K

CONSULTANT'S PLAYBOOK, COMPLEXITIES AND PITFALLS

Complexities and Pitfalls of Restaurant Workouts / Restructurings

- Restaurants are **service businesses** that liquidate for virtually nothing.
- Many chains do not own **real estate** and have limited other assets.
  - Furniture and Fixtures are generally **without** value.
  - Kitchen Equipment is in oversupply and may not be worth the risk to liquidate.
    - Recoveries could range from **$15K-$60K** (well maintained and/or new) per location.
    - Net out occupancy costs, rent, transportation, storage, auctioneer commissions.
    - If store locations are similar or standardized, then kitchen equipment may be easier to liquidate.
- Perfected liens on **Leasehold Interests** can be expensive and may provide limited value.
- Restructuring or terminating **leases** is often accomplished on a one-by-one basis.
  - Complexities of assumption and rejection of multiple lease
- Renegotiating Franchise Agreements
  - How and why do Franchisors impede Franchisee's from closing restaurants ?
- Proceeds from 363 or out-of-court sales may face large deductions.
  - **Working capital deficits** can consume up to 100% of the transaction proceeds.
    - Current assets can be < 20% of current liabilities.
    - Most current liabilities cannot be left behind in a Ch. 11/sales process.
    - Employee wages, true-up of franchisor payments, marketing commitments, soda rebates, food suppliers.
  - Deducts for short-term store leases on positive cash flow locations.
  - Cash needed to collateralize **Workers Comp LCs** that can be tied up for years.

CASE STUDY: FIC RESTAURANTS ("FRIENDLY'S")

FIC Restaurants

Wilbraham, MA

- 130 restaurants (50/50 corporate owned & franchised.
- $220 million (est) sales
- $88 million debt

BACKGROUND

- Founded in 1935 and lead with a premium ice cream product.
- Peaked at 850 locations in the 1980s with a concentration in the Northeast
- Multiple owners over the years including Hershey Foods (1979), Tennessee Foods (1988), public listing (1997), Sun Capital (2007)
- Chapter 11 Filing in 2011 but no offers made at auction and Sun Capital retained ownership with a $75 million payment to secured debt holders.
- Friendly's spent the years from 2012 to 2020 closing locations and ended 2019 at 138 units.

THE RESULT

- Company was faced with shifting demographics, increased competition and rising costs since 2011.
- Although significant improvements to combat these issues were made, the impact of COVID was too severe to continue operations.
- Filed for relief under Chapter 11 on November 1, 2020.
    - Listed less than $10 million in assets.
- Amici Partners Group, an entity affiliated with BRIX Holdings, agreed to purchase Friendly's for $1.99 million.
- Brix Holdings is a multi-brand franchising company that specializes in foodservice chains.
- As part of the deal, Friendly's lenders agreed to waive roughly $88 million in secured debt.

CASE STUDY: APPLE GOLD GROUP

Apple Gold Group

Raleigh, NC

- 110 Restaurant Applebee's Franchisee
- $185 million sales
- $75 million debt

THE CHALLENGE

- Company generating $3 million EBITDA and unable to service $75 million of debt
- 20 restaurants in loss position
- Applebee's brand in multi-year decline
- Over $10 million delinquency on Royalty and Advertising payments to Franchisor
- Franchisor demanding Franchisor directed sale that would result in $20 million loss to bank group and triggering various personal guarantees by Owner
- Owner giving lip service to taking decisive action

THE SOLUTION

- MorrisAnderson engaged as CRO over Franchisor objection
- Cash projections developed which demonstrated company had ability to pay partial royalty fees
- Company closed approximately 20 restaurants with Franchisor approval for $4 million improvement in EBITDA
- Negotiated early lease termination payments with approximately 10 landlords
- Structured sale process started with restaurant industry investment banker
- Started sale of company-owned restaurant properties

THE RESULT

- Company was sold in two out-of-court sale transactions
- Banks will get 100% loan recovery
- Owner avoided any significant losses due to potential personal guarantee enforcements
- Company avoided bankruptcy
- Approximately 2,000 jobs preserved
- All trade creditors and employees paid in full

PROFILES - DANIEL F. DOOLEY

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Dan Dooley, CTP, is a Principal and CEO at MorrisAnderson based out of Chicago. He has a strong national reputation in crisis management, operations improvement, debt refinancing/restructuring and C-level positions. He is a frequent speaker at industry conferences and a regular author for industry periodicals. Dan has served on the Board of Directors of both the American Bankruptcy Institute (ABI) and the Turnaround Management Association (TMA).

SERVICES

Dan specializes in interim management/CRO engagements, financial restructurings, creditor workout negotiations, cost and cash improvement plans, debt refinancings, asset sales and fiduciary roles.

INDUSTRIES

Dan has achieved positive and quantifiable results for companies in the following industries: aerospace, agriculture, automotive, capital equipment, distribution, food, healthcare, metals, oil and gas, real estate, restaurants, and transportation.

REPRESENTATIVE WORK EXPERIENCE

- CRO of over 20 clients including 100 restaurant Applebee's franchisee, $200M trucker, $100M magazine distributor and others.
- Receiver in Federal and State court in numerous cases.
- Liquidating Trustee for multiple bankruptcy estates.
- Expert Witness in bankruptcy litigation on preferences, plan feasibility and damage claims.
- Negotiated $100M+ debt restructuring and recapitalization for an oil and gas service company.
- Reduced inventory levels by 20% while maintaining consistent sales volume for a $600M seafood distributor.
- Structured Plan of Reorganization/refinancing out of Chapter 11 for International Technical Coatings, a Phoenix-based metal products manufacturer.
- Led the successful turnaround and debt restructuring of $100M+ 25 physician-owned cancer private practice.
- Led the successful $50M debt restructuring of a large non-profit religion-based community center.
- Successfully sold a $100M magazine wholesale distribution business into headwinds of a rapidly shrinking industry.
- Led the successful sale(s) of automotive supplier Drivesol Worldwide. Despite 2009 auto industry disaster, was able to sell 3 of 4 businesses which fully paid $30 million secured debt in 3 ½ months and generated $10 million for junior secured lender and the unsecured (30¢ dividend) on an out-of-court process.
- Led the successful section 363 sale of aerospace foundry Hitchcock Industries where the company sale netted $21 million in excess of all liabilities as a return to equity, an amount 3X expectations.
- While acting as Receiver, expanded and grew a chemical test lab business and sold as value of 6 times EBITDA, a value more than 5 times better than prior offers.

Prior to joining MorrisAnderson in 1997, Dan served as an executive with several Fortune 500 manufacturers including Illinois Tool Works (ITW), Allied Signal, Rand McNally and Burroughs. He has served on the Board of Directors and been a key advisor to small and large corporations and non-profit organizations.

Dan is a Certified Turnaround Professional (CTP). He holds a Bachelor's degree in Business Administration and an MBA in Finance, both from the Carlson School of Management at the University of Minnesota in Minneapolis. Dan is on the Board of Directors of the ABI and was previously on the Board of the TMA as well as President of the 1,000 member Chicago TMA chapter.

PROFILES – KAY STANDRIDGE KRESS

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Partner

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Kay has extensive experience restructuring debt and representing secured creditors in federal receivership actions. She also represents debtors, creditors' committees, secured creditors, trustees, individual creditors, and parties in interest—both as lead counsel and co-counsel—in out-of-court workouts and bankruptcy courts in the Eastern District of Michigan, Western District of Michigan, District of Delaware, Southern District of New York, and other bankruptcy courts in the United States. Institute Journal. Also, Kay has moderated and spoken on a variety of topics, including federal and state receiverships, both locally and nationally. She is a Fellow of the American College of Bankruptcy, a Fellow of the American College of Finance Lawyers, and Chair of the ABA Business Law Section's Bankruptcy Court Structure and Insolvency Process Committee. Lastly, Kay served as ABA Business Law Section advisor to the Uniform Law Drafting Committee for the Uniform Commercial Real Estate Receivership Act. The Act was approved by the Uniform Law Commission in July 2015 and has been enacted in seven states. She testified before Michigan House Committee on Judiciary prior to the enactment of the Act in Michigan.

In addition, Kay co-authored Chapter 83 "Creditors' Committees" for Colliers Bankruptcy Practice Guide; co-wrote "Alternatives to Bankruptcy Under Federal and State Law," a chapter in Navigating in Today's Environment; and authored the "Federal Receiverships" chapter in Guide to Receivership and Foreclosure. She also has written articles for Michigan Business Law Journal; the American Bar Association (ABA) Business Bankruptcy Committee newsletter, Business Law Today; and the American Bankruptcy Institute. Kay Standridge Kress has dedicated more than 32 years to providing clients with seasoned and pragmatic advice on corporate restructuring, insolvency, and bankruptcy matters.

Related to this panel topic, Kay has extensive experience representing secured lenders of securitized debt with respect to franchised restaurants.

AREAS OF FOCUS

- Secured Lender Representation
- Insolvency Litigation
- Debtor and Committee Representations
- Trade Creditors Representation
- Finance
- Financial Restructuring and Insolvency

PROFILES - COLIN MCCLARY

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Colin McClary is a Managing Director at MorrisAnderson. He brings valuable financing, banking, restructuring and private equity experience, having formerly worked in the Special Assets/Workout, Debt Private Placement and Corporate Banking Groups at Bank of America and as a Managing Director at Z Capital Partners LLC, a $2.3BN distressed-for-control private equity fund.

SERVICES

Colin assists clients with contract and lender negotiations, debt restructuring, capital raising, financial and operational analyses, cash flow projections, budgets, business valuations and the preparation of transaction and due diligence materials. Colin also consults with management to support strategic initiatives, corporate development, manages financial staff, and assists in the implement of tighter financial controls.

INDUSTRIES

Colin has worked closely with business owners, CEOs, and CFOs in various industries including: Branded Food and Consumer Products, Equipment Leasing, Trucking, Rail, Business and Consumer Services, Gaming, Manufacturing, Pharmaceutical, Medical Devices, Logistics, Banking, Finance Companies, and Energy firms.

REPRESENTATIVE WORK EXPERIENCE

- Managed and restructured over $2 billion of troubled middle market C&I loans.
- Negotiated and structured over 150+ loan/note documents and related security, inter-creditor and subordination agreements.
- Restructured approximately $175 million of Tier 2 capital for commercial bank holding companies, including the conversion of $35MM of Senior Debt to Tier 2 qualifying Preferred Stock.
- Structured and syndicated debt capital for companies located in Australia, New Zealand, Ireland, United Kingdom, Germany, Netherlands, South Korea, India and Italy.
- Executed a tax-free spin-out of a healthy 500+ employee Canadian subsidiary from its troubled U.S. parent.
- Negotiated with insurance companies to obtain savings on workers-compensation costs of approximately 25%.
- Developed 200+ capital provider relationships with commercial banks, insurance companies, private debt firms, business development cos. and private equity firms.

Prior to joining MorrisAnderson, Colin was a Managing Director at Z Capital Partners where he focused on identifying, sourcing and evaluating potential acquisition targets and managing lender relationships. Duties included preparing industry studies, valuation analysis and legal documentation review. Colin holds a BS degree in economics from DePauw University and a Masters degree in finance from the University of Illinois of Champaign-Urbana.

PROFILES – DUNCAN BOURNE

Duncan Bourne

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Duncan Bourne has been with Wynnchurch since 2003. He brought more than twenty-two years of consulting and operational experience to the firm, including stints as Senior Manager with Ernst & Young, Senior Associate with Alix Partners and Partner with BDO Seidman LLP. Duncan began his career with BP Amoco as a chemical engineer. He is a Certified Turnaround Professional and a Certified Insolvency and Restructuring Advisor.

EXPERIENCE

Duncan has more than 35 years of experience in turnarounds, financial restructurings, operational performance improvement and investing in special situations.

EDUCATION

B.S., Chemical Engineering, Northwestern University
MBA, University of Chicago

PROFILES – MICHAEL G. BOUDREAU CPA, CTP, CFF

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Michael Boudreau CPA, CTP and CFF is a Director at Morris Anderson. Mike has over 25 years experience delivering professional services and exceeding expectations. Mike's expertise includes Workout & Restructuring, Corporate Finance / Debt Refinancing, Operations /Enterprise Improvement and C-level positions. Mike is a frequent author for industry periodicals and speaker at industry conferences.

SERVICES

Mike has represented Debtors, Lenders and other constituents both out of court and within a Federal or State court proceeding. Mike has been Financial Advisor to underperforming companies and optimized results on a regular basis. Within a Federal bankruptcy proceeding, Mike has guided companies through the Debtor in Possession (DIP) process and exited bankruptcy through plan confirmation and / or a 363(b) asset sale. Within State court, Mike has optimized recoveries as a Court Appointed Receiver and an Assignee for the Benefit of Creditors (ABC).

Mike has also helped growing companies secure additional capital by going to market for larger and more complex credit facilities as well formulating bank groups for his clients.

INDUSTRIES

Mike has extensive expertise in the automotive supply chain including Tier I, II and III parts, tooling and service providers. Additionally, Mike has a deep knowledge base and experience level with distribution, construction and building trades, real estate, restaurant chains, health care, food processing, aerospace and many others.

REPRESENTATIVE WORK EXPERIENCE

- Financial Advisor involving over two-hundred (200) automotive suppliers. Engagements included refinancing, restructuring, profit improvement and sell side transactions.
- Financial Advisor to a Tier II plastic injection molder and tool shop. Instituted cost reductions, improved working capital, negotiated trade debt and refinanced the secured debt.
- Court Appointed Receiver to numerous automotive suppliers resulting in maximum returns to the estate by finishing work in process inventories and creating significant buyer interest for the asset base.
- Chief Restructuring Officer for a durable goods manufacturer with a food processing division. Stabilized operations through cost reductions, improved working capital and re-financed bank debt.
- Financial Advisor to a Ten Member bank consortium on their $100 million credit facility. Debtor was in the consumer products space and imported finished goods to their vast North American distribution centers and retail outlets. The transaction included a DIP lending facility, Chapter 11 filing and a 363(b) asset sale resulting in a 100% recovery.
- Financial Advisor to a franchisor and restaurant chain with $1 Billion of systemwide sales including company owned and franchisee stores. Restructured operations, negotiated trade debt, marketed the company for sale and filed a Prepackaged Chapter 11 to sell the enterprise in a 363 (b) asset sale and significantly minimize the time in bankruptcy.
- Court Appointed Receiver to a 100 bed Assisted Living Center and Memory Care unit. Marketed and sold the facility to a REIT.
- Financial Advisor to a Midwestern 400 bed Assisted Living Center, Skilled Nursing, Memory Care and Long-term care facility. Successfully re-financed the secured bank debt.
- Court Appointed Receiver to a residential real estate development resulting in an asset sale for highest value.
- Financial Advisor to a non-profit. Reduced operating costs, restructured unsecured creditor payments, achieved key milestones and extended secured loan agreements.