LINCOLN INTERNATIONAL

Restaurants Market Update 2H 2020

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Restaurants Insights for 2021 and Beyond

As restaurant owners leave a challenging 2020 year in the rear-view mirror, the industry must now navigate a similarly unique period ahead with the ongoing uncertainty caused by the pandemic. While government stimulus is expected to drive incremental sales for restaurants in Q1 2021 and pent-up consumer demand will lift sales for most restaurants once dining rooms re-open (hopefully in 2H 2021), restaurant owners will need to continue to be innovative to take advantage of the key trends. Operators who both adapt to evolving consumer preferences molded by the current environment and manage the complexities related to dining rooms re-opening will be well placed to take market share. Ultimately, 2021 will be a transformative year for the industry and will be represented by many of the same themes catalyzed throughout 2020.

As 2021 progresses, the sector will see a continued polarization between winners and losers. This dynamic has been prevalent in the industry for a number of years and the pandemic has accelerated the widening of the gap. Weaker brands that faced declining sales pre-COVID and independent restaurants that might lack the financial wherewithal to navigate the unique environment will likely continue to struggle and face some tough decisions. 2021 will be the year for operators that have strong brands, high consumer loyalty and strength in the off-premise channel.

A focus on omni-channel has never been more important in the industry. Restaurants that can capitalize on off-premise initiatives and digital leadership will continue to attract consumers and strengthen their brand. Brands that can evolve and display some of the following characteristics should be well-placed to win in 2021:

- Profitable delivery ecosystem (whether through third-party delivery partnerships or a more attractive white-label proprietary delivery system)
- Meaningful drive-through sales mix
- Digitally integrated curbside pick-up channels
- Menu innovation and additional options for customers (e.g., alcohol to-go will continue to be a new category of sales for restaurants)
- Ability to tap into new dayparts
- Successful integration of ghost kitchens (which will benefit brands that are mature enough to have robust delivery channels)
- Strategic expansion with virtual brands
- Development of new store prototypes (e.g., that are re-engineered with a focus on smaller units given an increase in off-premise sales and to optimize labor)
- Ability to retain off-premise sales once dining rooms re-open

Restaurant owners are ready to put 2020 behind them. Those who can successfully navigate the complex environment prior to a return to "normalcy" will be well-positioned to capitalize on future growth opportunities.

Trends

Customer & Employee Safety	Off-premise	Omni-channel	Ghost Kitchens	Virtual Brands
Food Transparency & Traceability	Streamlined Menus	Labor	Heightened Cleanliness	Technology

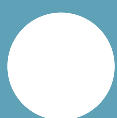
2021 Mergers and Acquisitions (M&A) Outlook

Based on the ongoing uncertainty caused by the pandemic, strategic buyers will mostly continue to be inward focused with a limited appetite to seek out acquisition targets. They will be focused on operating their own brands and preserving liquidity until there is more visibility into post-COVID performance.

Alternatively, financial buyers that are experienced investing in the sector will continue to remain active in 2021. The pandemic has driven financial buyers to be more flexible as they consider investing in the space, with a number of sponsors that historically would have only considered traditional buyouts now having the flexibility to pursue more structured and minority equity investments. In addition, private equity firms are sitting on record levels of dry powder and are under immense pressure to deploy this. One result of this is an increase in proprietary deals, with financial buyers more active in approaching other private equity and family office investors on a one-on-one basis to try and unlock an asset before it is potentially brought to market in a broader auction process.

As a result, Lincoln anticipates near-term M&A will be dominated by financial buyers while strategic buyers largely remain on the sideline. Financial buyers will continue to be very aggressive for brands that performed well through COVID-19 and have demonstrated an ability to adapt to the new environment and a right to win in the off-premise channel. Whilst lenders will continue to remain cautious, we expect financial buyers will be willing to over-equitize buyouts in the near term as they seek to put capital to work and pursue attractive and strong performing brands.

Category Breakdown

	Expected M&A Activity	
QSR		▪ Buyers will be keenly focused on the "COVID-bump" in sales and sustainability of performance / what sales growth looks like once things return to normal ▪ Buyers will want to understand how working from home will impact the quick service restaurants (QSR) category and day part mix ▪ Specific attention will be paid to the franchisee space ▪ Lenders remain active within this category
Fast Casual		▪ Buyers will be focused on the stickiness of off-premise sales and the strength of the brand ▪ Strong interest in "better" performers ▪ Those that were not able to pivot to off-premise channels and have lower average unit volumes may not attract as much interest ▪ Some lender interest if the brand performed well during COVID-19
Full-Service		▪ Hardest category for potential buyers given impact of COVID-19 ▪ There are some strong performers, but in general, the category is still down ▪ Expect lower investor interest until dining rooms are back open and post-COVID performance known ▪ Lenders are avoiding the category in most cases

Select 2H 2020 M&A Transactions

Closed	Target Company	Business Description	Acquiring Company
Dec-20	Legal Sea Foods	Operates a chain of casual-dining seafood restaurants mostly located in the Northeastern region of the United States	PPX Hospitality Brands
Dec-20	Garbanzo Mediterranean Fresh, Frutta Bowls	Garbanzo is a Mediterranean restaurant, while Frutta Bowls is a fast casual concept serving a variety of superfood bowls and fresh fruit	Saladworks (Centre Lane)
Dec-20	PJ United	Owns and operates Papa John's restaurants in Alabama, Louisiana, Texas, Ohio, Tennessee, Illinois, Missouri, Mississippi and Virginia	The Halifax Group
Dec-20	Les Rôtisseries Fusée	Operates a leading rotisserie-style chicken chain with 21 restaurants in the province of Quebec	Foodtastic
Nov-20	Torchy's Tacos	Offers a wide selection of handcrafted tacos, queso and margaritas	D1 Capital, T. Rowe Price, Lone Pine Capital and XN
Nov-20	Zaxby's	Offers chicken fingers, jumbo buffalo wings, sandwiches, salads, appetizers and sauces	West Street Capital Partners
Nov-20	27 Five Guys Restuarants	Operates 27 Five Guys in Texas	Encore Restaurants
Oct-20	Corner Bakery Café	Offers specialty breads, hot breakfasts, seasonal soups and freshly baked sweets	Pandya Restaurant Growth Brands
Oct-20	41 IHOP Restaurants	Operates American breakfast & diner restaurants with a wide variety of pancakes	Sun Holdings
Sep-20	Tropical Smoothie Cafe	Operates a chain of cafes in the United States	Levine Leichtman
Sep-20	70 KFC Stores	Operates American fast food chain that specializes in fried chicken	Restaurant Brands New Zealand
Aug-20	Red Lobster Seafood	Owns and operates a casual dining seafood restaurant chain	Thai Union Group

Source: Capital IQ, Mergermarket, Pitchbook and company data

Unlocking the Balance Sheet to Support Future New Unit Growth

It has been choppy waters for restaurants since COVID-19 hit in late March 2020. Generally, restaurants have outperformed budgets that were set in the early months of COVID-19 as operators demonstrated extensive resolve to stay open and support their customers. The path forward remains murky with COVID-19 cases fluctuating and dining restrictions changing regularly by state and/or county. Restaurant operators have had to be flexible and innovative to survive and drive sales in the most challenging operating environment in U.S. history, and they will need to remain creative to engage with consumers, drive customer loyalty and ultimately support their brands over the coming months.

Lincoln International's Valuations & Opinions Group has seen revenue and EBITDA declines across the portfolio of restaurants that they value on a quarterly basis.

Real Estate Opportunity

Any restaurant with meaningful leverage likely breached covenants in 2020. Whilst Paycheck Protection Program loans and lender patience (somewhat dictated by the restaurant investor environment) have extended the runway for many restaurants, operators remain constrained by covenant breaches, which typically restrict their ability to invest in new unit growth, even if they have cash on the balance sheet. And despite the real estate environment opening up slower than expected, opportunities will continue to arise. Those brands that remain handcuffed by their leverage profile will be forced to sit on the sidelines, which will ultimately limit their ability to reignite growth and create long-term value. Those brands that have the flexibility to be more aggressive will be in a position to take advantage of these unique real estate opportunities and accelerate growth in the near term, creating momentum that can fuel attractive sales and profitability growth and create incremental future value for the shareholders.

How Lincoln Can Assist in Right Sizing the Balance Sheet

Junior Debt

Structured Capital

Growth Equity

Lender Negotiations

Lincoln's broad experience and track record raising debt and equity during COVID-19 provide unique insights into investor activity, as well as the latest market terms. Both debt and equity investors are sitting on record levels of dry powder and remain eager to deploy capital. Many equity investors who were previously focused on control investments have expanded to also consider minority equity opportunities. Lincoln has deep relationships with investors across the capital spectrum, understands the options available to restaurant operators and knows the investor universe for all situations.

Right sizing the balance sheet can ensure capital is available to capitalize on unique real estate opportunities and drive new unit growth in the near term, creating long-term value for the company and its shareholders.

Lincoln has closed 20+ debt and equity capital raise transactions since the onset of COVID-19

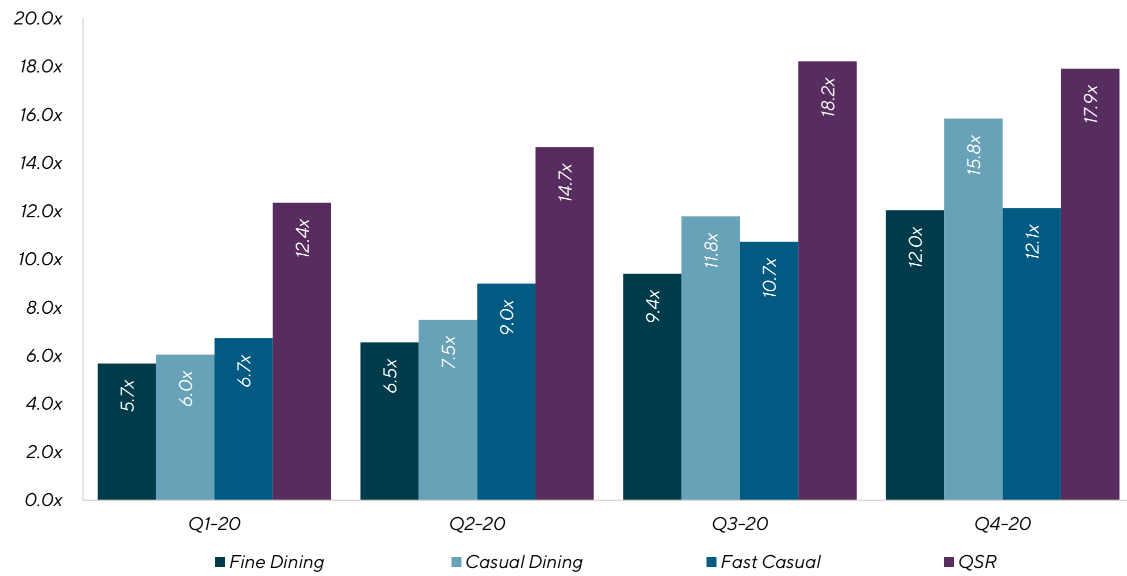
Insights

During 2H 2020, the Lincoln International restaurants indexes and the S&P 500 rebounded from the lows experienced in 1H 2020. The recovery reflects greater optimism for the ability of restaurants to navigate the COVID-19 environment with off-premise initiatives, as well as hopefulness for a near-term path toward returning to 2019 performance levels.

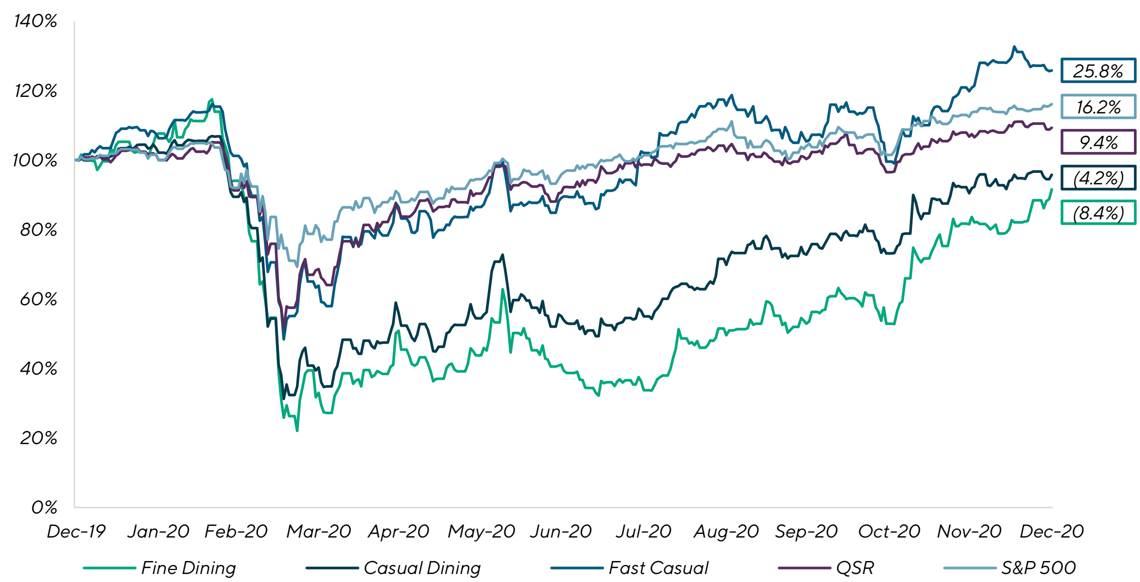
All public restaurant subsectors saw an increase in EV / EBITDA multiples in Q4 2020 (vs. Q2 2020) as the stock market recovered from the initial shock of the COVID-19 pandemic. Segments exhibiting the strongest performance during 2H 2020 included fine dining, casual dining and fast casual dining, as the market began to give operators in those sectors credit for initiatives implemented and an improvement in sales trends since the start of the pandemic. Though industry dynamics remain unique, continued re-openings, vaccination efforts and pent-up demand are expected to lift 2021 performance.

Restaurant Market Update

Median Enterprise Value / LTM EBITDA



Stock Market Performance



Sub-sector Valuation Statistics

Sector	Number of Companies	EV / Revenue			EV / EBITDA			EBITDA Margin			EBITDA as a % of CY 2019 EBITDA			Net Debt / EBITDA
		CY 2020	CY 2021E	CY 2022F	CY 2020	CY 2021E	CY 2022F	CY 2020	CY 2021E	CY 2022F	CY 2020	CY 2021E	CY 2022F	CY 2021E
Fine Dining	2	1.58x	1.20x	1.10x	42.0x	10.4x	8.3x	5.3%	11.1%	12.7%	50.3%	107.0%	130.2%	1.3x
Casual Dining	17	1.97x	1.57x	1.35x	18.1x	11.5x	9.0x	7.7%	11.8%	12.5%	44.9%	89.3%	103.7%	3.5x
Fast Casual	9	1.65x	1.59x	1.50x	23.0x	14.7x	12.8x	10.1%	14.3%	14.0%	87.5%	119.1%	133.7%	0.9x
QSR	10	4.58x	4.34x	4.08x	17.6x	16.3x	16.0x	27.2%	27.2%	27.3%	98.7%	109.1%	118.6%	4.5x

Sources: Capital IQ, ThomsonONE, Wall Street research and company data

Advisory Services

Mergers & Acquisitions
Capital Advisory
Joint Ventures & Partnering
Valuations & Opinions

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