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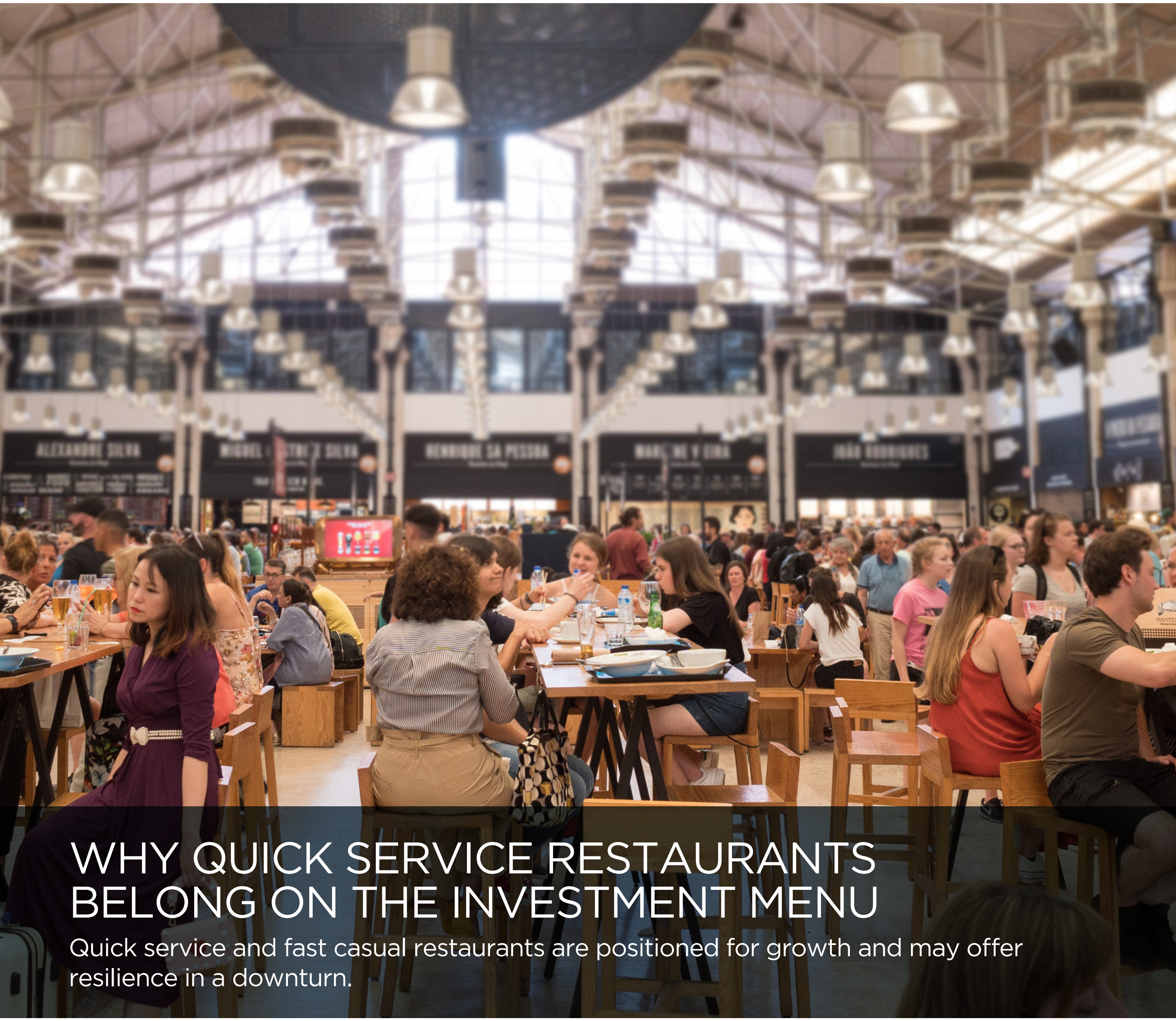


WHY QUICK SERVICE RESTAURANTS BELONG ON THE INVESTMENT MENU

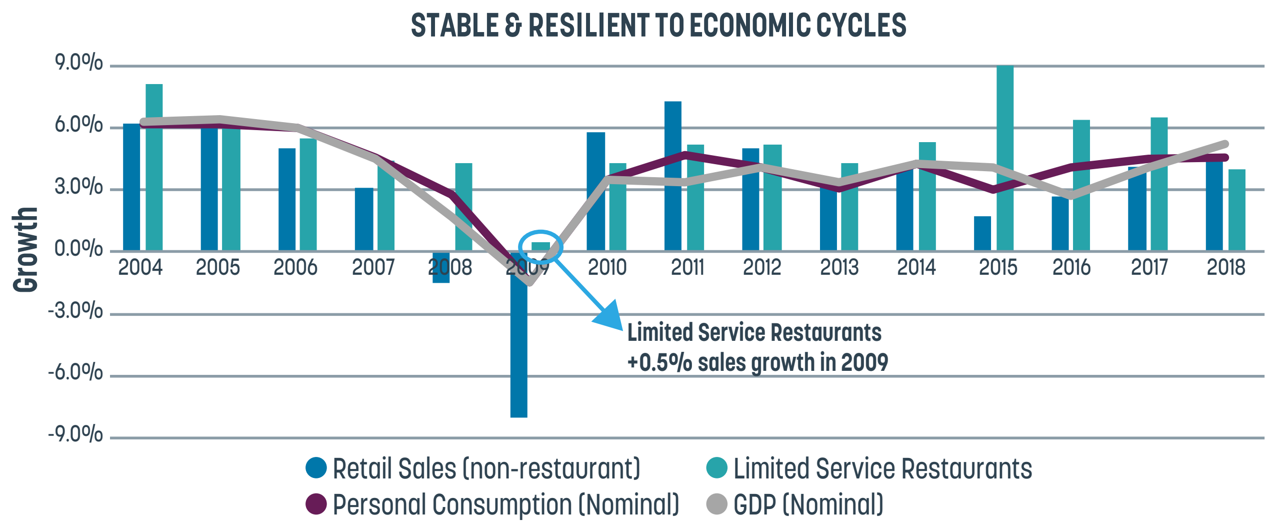
Quick service and fast casual restaurants are positioned for growth and may offer resilience in a downturn.

When seeking out recession-resistant investments, the restaurant industry may not be the first place investors look, but they could be missing an opportunity. Certain categories within the restaurant industry, most notably quick service restaurants (QSRs) and fast casual restaurants (FCRs), offer affordable menus that often lead to stable consumer demand, even under weak economic conditions.

In fact, consumers may be more likely to eat at QSRs and FCRs during a recession, as they are inexpensive and convenient. During the global financial crisis, these restaurants proved to be attractive investment options, as they exhibited modest sales growth even as the rest of the economy contracted (Exhibit 1).[1]

For many families, the solution to this challenge has been to cook less (historically reported as the most time-consuming domestic task[3]) and dedicate more income toward take-out and delivery. Data from the USDA shows that food-away-from-home accounted for 54% of total food expenditure in the U.S. in 2018, up from 50% in 2009, and around 25% in the 1950s (Exhibit 2).[4] This trend is particularly pronounced among younger consumers, as eating out represents a greater share of total food spend for each successive generation.[5]

Exhibit 1:
Limited-Service Restaurants Are Stable and Resilient to Economic Cycles



Source: US Census Bureau, BEA.gov, and Restaurant Research. For illustrative purposes only.

TRENDS SHAPING THE RESTAURANT INVESTMENT OPPORTUNITY

In addition to their relatively resilient nature, the QSR and FCR segments of the restaurant industry are poised for significant growth in the coming years, thanks to several overarching trends.

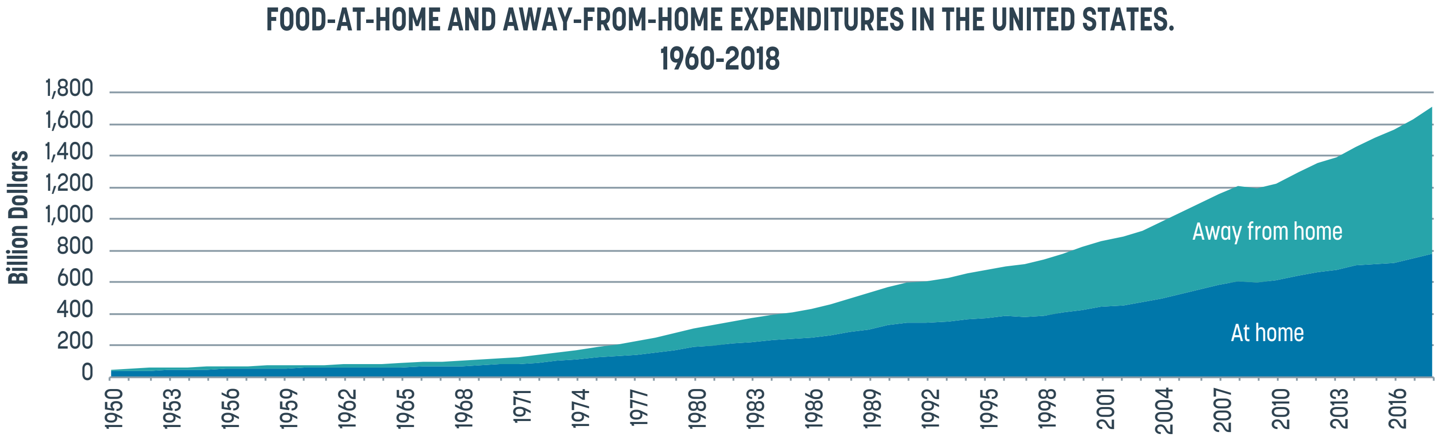
Consumers have less time to cook

Americans lead busier lives than ever and have less time for traditional household activities. According to data published by Pew Research in June 2019, the percentage of dual-income households in U.S. has risen to 66%, up from 49% in 1970.[2] Technology is also keeping American workers connected to their jobs during all hours of the day, while children face growing pressure to partake in numerous extracurricular activities.

QSRs and FCRs are expanding menu options for health-conscious consumers

Many restaurants have updated their menus with items designed to attract different types of customers. The addition of menu options that are perceived to be healthier, for example, makes quick service restaurants more attractive to health-conscious consumers who might otherwise not buy fast food. Numerous fast food chains now offer menu items that are food-allergy friendly or aligned with popular diet trends, which has allowed these businesses to broaden their addressable markets. Additionally, the fast food industry as a whole offers consumers a variety of options, ranging from burgers to pizza to Mexican cuisine, further enhancing the appeal for consumers.

Exhibit 2:
Time-Pressed Consumers Are Increasingly Dining Out



Source: USDA, Economic Research Service, Food Expenditure Series. For illustrative purposes only.

Technology offers easier food delivery and provides additional revenue opportunities

Technology developments in the food service industry have made dining out (or in) easier than ever. The rise of startups such as DoorDash, Postmates, and Uber Eats has made meal delivery simpler and more efficient. This has led to a surge in online and mobile ordering. By 2020, food delivery app usage in the U.S. is projected to surpass 44 million people and reach nearly 60 million people by 2023. The global market for online food delivery is expected to grow to $365 billion by 2030, representing a 20% CAGR from 2017 levels.

Further, operators continue to invest in technology to generate additional revenue opportunities and improve profitability. Nearly 50% of restaurant chains intend to increase their technology spending over the next year, with much of that investment going toward artificial intelligence (AI). Several prominent brands are implementing AI to power their online ordering service with chatbots. Many operators are also installing ordering kiosks with AI engines to reduce customer wait times and implement targeted selling, where the systems detect ordering patterns to generate suggestions for additional items. Finally, technological innovations have helped restaurant owners improve their margins by becoming more efficient in the way that they track food costs and manage their supply chains.

DEMAND FOR CAPITAL

Growth across the industry has led to a high demand for capital, with a total financing need across the sector estimated to range from $15 billion to $20 billion annually. Within the quick-service and fast-casual segments, several recent trends are reshaping the competitive landscape and driving the need for capital. Most notably, many large brands have gravitated toward supporting a smaller number of franchisees, favoring proven operators who can deliver strong results across a large portfolio of locations. As a result, franchisors have been actively buying locations from weaker operators and selling them back to stronger ones, who often require financing options to complete the transactions.

INVESTMENT STRUCTURING

Many franchise operators have shown a preference for non-dilutive financing, opting to take on debt rather than equity investments. This has proven to be an attractive proposition for potential investors, as it allows them to invest in senior secured loans, which mitigate downside risk. Such loans are often privately negotiated and therefore lack a liquid secondary market. However, they typically provide current income from contractual interest payments, often at a premium to yields from public fixed income securities, allowing investors to realize returns more quickly than they would from private equity investments.

A LATE-CYCLE DIVERSIFICATION OPPORTUNITY

Food and beverage products elicit daily demand regardless of business cycles, as consumers continue to eat three times a day even when their incomes are squeezed. In fact, the low-cost nature of limited-service restaurants often makes them more attractive during difficult financial times. As investors look for ways to diversify their portfolios to protect against a potential recession, the QSR and FCR segments should provide low correlation to the broader economy while offering meaningful growth potential.

END NOTES

[1] Source: U.S. Census Bureau, BEA.gov & Restaurant Research

[2] Source: Pew Research Center, "8 Facts about American Dads," June 2019. https://www.pewresearch.org/fact-tank/2019/06/12/fathers-day-facts/ft_17-06-14_fathers_dual_income-2/

[3] Source: Bureau of Labor Statistics, as of 2018. https://www.bls.gov/charts/american-time-use/activity-by-hldh.htm

[4] Source: United States Department of Agriculture, as of 2018. https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=58364

[5] Source: CapitalSpring Industry Update Q4 2018: Food Away from Home on The Rise; U.S. Department of Labor

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IMPORTANT INFORMATION / DISCLAIMER

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