Company Participants

- Cindy McLoughlin, Hospitality Industry Leader
- Gary Levy, CPA, Managing Partner, Consumer, Hospitality, Manufacturing Practice
- Michael Halen, Senior Restaurant and Packaged Food Analyst
- Sarah Lockyer, Senior Vice President, Restaurant Business

Presentation

Michael Halen {BIO 18797919 <GO>}

Good morning. Welcome to BI & CohnReznick webinar on the restaurant Industry through the year 2020. So I am Mike Halen, I am an analyst here at BI. Just quickly we will go through some administrative notes. We're going to record this and send it out for playback, also send out transcripts of the meeting. You can access the replay via the link that you used to sign up. At the bottom of the slide window, you can change the volume and maximize your screen to see the slides a little bit better. Feel free to ask questions by submitting one to the right of the slides. We're going to try to address as many as we can near the end of the presentation. And a copy of the slides will be distributed via email.

So quickly; BI, we cover hundreds of industries and sectors doing sell-side like research for Bloomberg. Our stuff can be accessed via the terminal on BI . And I'm going to kick it over to our moderator, Cindy.

Cindy McLoughlin

Thanks, Michael. So today, as mentioned, we're going to be talking about the state of the restaurant industry over the next few years; so what's going on now and where we see the trends going over the next couple of years. We've had a lot of dynamic changes in the industry, obviously, over the past year. So we're going to kind of focus on a couple of areas. One, we're going to talk kind of from a macro, how the economy is looking at in the markets. And then we're going to kind of go into tax reform. Obviously that's just something very new on the docket here and has been a real game changer, strategically how people are thinking and where we're going to go. And then of course with all of that, we're going to lead into the consumer trends and technology and how the market and how the new trends are really going to lay out over the next couple years.

So, with that, I have some wonderful -- as you see there on the slide, some wonderful speakers with us that are going to help us navigate through that. I have Gary Levy, who is CohnReznick's next Managing Partner of our Consumer, Hospitality & Manufacturing Practice. I have Michael Halen, who is the Senior Restaurant & Packaged Food Analyst at Bloomberg Intelligence; and Sarah Lockyer, Senior Vice President at Restaurant Business.

So, with that, I think let's just go right on to the content. Let's talk about the state of the restaurant here. Let's get to that first slide. We always like seeing graph. So this is an interesting one. Michael, let's have you kind of kick it off. I mean, what is driving the same-store sales growth? Is it price, traffic, where are we headed here? What does this all mean?

Michael Halen {BIO 18797919 <GO>}

Yeah, as you can see, sales have decelerated since January of 2016. We've seen things pick-up a little bit here in the last few months based on MillerPulse data, it's a third-party data provider that we use. But price increases are being mostly offset by traffic declines. So restaurants aren't exactly knocking the cover off the ball right now in terms of growing sales. I mean, there's some -- a bunch of different things going on right now. Independents are taking share on providing local ingredients, which they can do better than national chains can. Ethnic cuisine is also attracting customers that cannot get the same type of food at a Chili's or an Applebee's. There's also been a widening gap between the cost of eating at home versus away from home. So what we're seeing is people are brown-bagging their lunch maybe a little bit more frequently or cutting back on their visits on restaurants. And then finally, income growth has pretty much been flat now for the last decade, but healthcare, student loan and rent costs are all increasing.

We do have this little boost here over the last couple months. We tend to think it's transitory, part of it's due to very easy comps and a lot of it's been fueled by casual dining chains. So in our view that turnaround really isn't sustainable, because they haven't figured out a way to attract millennials to their stores.

Another big reason why we've seen kind of weakness over the last couple years is oversupply. So this is just a chart of the top 100 chains. So we're not even talking about independents here, we're not talking about emerging fast casual brands. We're just talking about the top 100 chains and a lot of them including -- a lot of them -- this includes a lot of casual dining chains that are actually flat to shrinking units here in the United States and it's still up 13% since the recession. So there's a lot of restaurants out there, a lot of these new restaurants are taking sales away from existing ones. Another issue (multiple speakers)

Gary Levy {BIO 17914334 <GO>}

Sorry. It's Gary. Just wanted to weigh in. You also have a lot of restaurants that have private equity money behind them and obviously they are being fueled for growth and adding more stores pretty quickly, and that's not even in the data or in the slide, so significantly more restaurants coming online.

Michael Halen {BIO 18797919 <GO>}

Yeah and landlord -- and retail struggling. So landlords want restaurants and they bring foot traffic into their developments. So all of this is weighing in. And we talk about the big change in trends and this chart really exemplifies that. There's a huge demographic shift going on. Millennials now are the largest generation in the United

States. Baby boomers are retiring at a very rapid clip. They're moving to more fixed budgets and they are spending less money out at restaurants, specifically casual dining restaurants.

So what's interesting is they've done a little bit better over the last quarter. Think about Darden especially, maybe Chili's, they're kind of trying to get back to -- reach back out to their casual dining, baby boomer casual dining customers with nostalgia, menu items like Applebee's riblets and chicken fingers that attracted these same customers maybe 20 years ago. So we've been calling it kind of a bird in the hand strategy where they kind of start pushing so hard for the millennials that they've been unable to attract anyway. We think this is smart near-term, but casual dining restaurants still have to find a way to get the younger generations in their stores to survive long-term.

Another shift that we're going to start to see is that the millennials who throughout -- their coming of the age have been visiting restaurants at a much higher clip than some of the other generations out there. Well, they are starting to settle down, get married, have kids, buy homes, so this gives them less money to spend out at restaurants as well.

And then on the cost side, we are still seeing minimum wage increases, so 18 more states in 2018 raising their minimum wages and three of them, California, Florida and New York are three of the top four states in terms of restaurant spending. So another headwind for these restaurants.

Cindy McLoughlin

And, yet, we are seeing these valuations still are just crazy on every front. It's like sustainability of this. I mean, are you seeing the earnings really being able to support those kind of valuations or where do we sit with that?

Michael Halen {BIO 18797919 <GO>}

Yeah. So earnings are being boosted by levering up and refranchising, especially in quick service restaurants and these chains are using the proceeds to repurchase shares. So you're seeing in EPS, maybe not as much in net income, but the EPS growth is definitely there. I mean, but there's a couple of other things also going on. Stocks have been on fire despite these headwinds, A, due to tax reform and the hopes around it; B, it's the best house on a crummy street. It's really hard if you're an investor to tell your -- if you're a hedge fund manager or a mutual fund manger to tell your investors that you're buying department stores and retailers right now. People don't want to hear it, because of the Amazon threat. It's a lot -- people feel like they can sleep easier at night owning restaurants versus retailers. So that's part of it, a lot of money is just moving from retail into restaurants.

And I'd say the last one is that M&A has really boosted valuation. And with that, as we see it, it's likely to remain high, especially in the first half, tax cuts and cheap money are going to continue to motivate buyers and sellers after a pretty big year for deals last year. And as you mentioned Garry, private equity funds are searching for smaller, emerging growth chains now more than they ever have. And so part of this is due to the evolving customer demographics, behavior and taste. So they want fast casual. They don't want casual dining. They want the ability to pick up and go whenever they want. They don't want table service. So this shift -- with this shift we've seen a lot of money flow to these emerging fast casual brands and also the strategic buyers are back -- some of them --

Gary Levy {BIO 17914334 <GO>}

Sorry to interrupt. I was just going to say, you're definitely seeing it with PE activity being, new PE funds coming into the space and strategics to getting very active. I had seen several PE funds taken to private, and then -- go ahead, I am sorry.

Michael Halen {BIO 18797919 <GO>}

Yeah. No, that's great. So the strategic buyers and I guess, some of them never learn. I mean, it's not easy to house multiple brands under one roof. And over the last 20 years, they haven't gone really that well, but there's pressure on the top line. So, some of these chains, specifically restaurant brands Darden and Yum, they're looking to acquire pretty sizable change chains with significant growth prospects here in the US, and also internationally. We've seen all of these raising a couple of billion dollars to buy additional restaurant chains. And then on the low end, you've also seen chains like Cheesecake Factory make investments in smaller growth concepts just to look for another growth engine for them.

Cindy McLoughlin

With the tax reform and everything and all the sort of access to capital on every front now, and obviously also coming out of the tax changes, I mean, this is giving these companies that capital to invest in other units or doing strategic acquisitions as well.

Gary Levy {BIO 17914334 <GO>}

And I was just going to add that, it's typical. Historically in the last part of the decade strategics get active and start doing transactions, that's usually historically what has happened and you are absolutely seeing that.

Michael Halen {BIO 18797919 <GO>}

So, just I'm going to tie up this part with a little reference to tax reform. And despite the PR spin that you're really seeing, most of the tax reform cash is really going to be going back to buybacks. There'll be some spending intact and investments in labor, because they need to stay competitive. But listen, like I said earlier, chains have been levering up. Now that with leverage ratios that are near the high-end of their comfortable range, they can't borrow for buybacks anymore. Most of these chains now, especially in quick-service are 95% plus franchise. So they can't re-franchise to bring up to -- to drum up more cash for buyback. So the boost to free cash flow, most of it is going to go to fund stock buybacks.

As I mentioned, companies like Starbucks and Brinker mentioned, they're going to make some investments in labor, because the labor market is tight for restaurants. But remember, last time, Starbucks raised wages, they actually cut employee hours. So this just goes back to the point I made about chains being in PR mode and trying to say the right things with the tax reform backdrop. But investment dollars will be allocated to technology. I mean, the companies that are doing this well, Domino's, Panera, Starbucks to name few are picking their pants off their competition. So these chains know that these investments have to be made, and the ones that do it well are going to be the ones that take share.

Cindy McLoughlin

Okay. So now let's sort of shift a little bit to what tax stuff means. You're going to see a lot of these public companies, when they are reporting their earnings, and as they're starting to file now, a lot of these really large sort of wacky non-cash adjustments on the tax side and all of this [ph] is a fallout obviously, because of the effective rates in going forward and how they're having to adjust for their deferred taxes. So you kind of have to muddle through some of those things, those adjustments as you're seeing it. But you've seen kind of a lot of that out there in the press on the larger companies, and how that's really impacting them. But let's shift through all of that and kind of move forward into sort of the main ideas and main things that are out there, and how it's going affect hospitality companies specifically.

So, Gary, why don't we go forward here and talk a little bit about some of the positives and the negatives and sort of highlight that and step through this.

Gary Levy {BIO 17914334 <GO>}

Alright. Thank you, Cindy, and thanks, Mike. Good job laying the foundation. Let me say this in the very back [ph] the disclaimer about some of the things we are going to talk about, because the code has not been written yet, it's been laid out. But it actually now pending to be -- taken out to paper by the lawmakers and the actual code disseminated throughout. So maybe it's a good idea of what it means, but the final rules aren't out there yet, so -- and I'm sure there will be some adjustments as we go.

The Tax Cut and Jobs Act or as I call it, the Trump Tax Plan, it's really a -- if you are a believer in the Laffer Curve and sell-side economics and that being working, then this is a plan you're going to like. That is yet to be proven, but that's certainly something to keep an eye on. There is some pretty good positive things about this. They are right there into some negative things. And you need to be proactively thinking about how these pieces of the code work, because in one area you may say this is a great thing, I'm going to do this. But one of the bad things in the code may kick into play and eliminate what you're trying to accomplish. So you really have to take your time, be proactive, and bluntly do the modeling. Think about where you are taking the company, and what your goals are.

There's going to be a transaction and an exit, when do you want to do that. We've been meeting with a lot of companies and lot of PE funds to help them look at this and decide, hey, what's the right entity, what portion of this tax code should we seriously be thinking about implementing or trying to navigate around. So the positives are pretty simple. There is lower tax rate both for C corps and for individuals, we'll talk about that a little bit more. The C corp changes are permanent, the individual rates kind of sunset over different periods of time, something to think about. And the positive thing is, this pass through tax deduction, that's for flow through entities like S Corps and LLCs that qualify. There's a nice deduction there that is going to be very beneficial to restaurant owners.

They've opted the depreciation rules and increased bonus in Section 179 that significantly encourages investment in the industry as you build restaurants. They've also kept the tax credits that are pretty important in the industry. The FICA tax credit and The Work Opportunity Tax Credit known as the WOTC. Every year, there's always banter about eliminating the FICA tax credit. I was pretty sure it was going to go away this time around, but they've kept it. That's a really good one. And the WOTC credit is something a lot of restaurant companies have been using, and more recently, more and more are looking at it, because it helps alleviate the rise in minimum wage, as well as it gives access to a larger labor pool. And if you're not doing that, I think that's something you should be looking into. Those credits can be very significant, those dollars add up. We've been helping a lot of companies look at that and finding the best way to implement it.

And lastly, there's some favorable international tax regulations. I'm going to touch on that. We could do a two hour webinar just on that alone. Bottom line, that's really to make the US more competitive on the world stage and help repatriate some dollars into the US. The negatives, the limitation on state income tax deductions and limitation on new mortgage interest. Well, if you live in a state that has high income taxes, this may not be so beneficial to you and certainly if you have high property taxes, it's not going to be beneficial for you. And I just don't see how that does not hurt the housing, the valuation of houses in certain parts of the country. There are some limitations on business losses, those are confusing. They're going to have some, I think, wide-sweeping effects on some strategies people employee in growing their businesses. And lastly, interest expense limitations that also come into play that I think will change how deals are structured and how capital is raised going forward.

So, here are the -- just a quick overview of the tax rates. You see the C corp rate is 21%, the AMP is eliminated, and like I said, this is a permanent change, so that goes on forever. And you look at it and go, wow , what a low flat rate I got for C corps, I'm going to convert everything to a C corp. A lot of companies are looking at doing that. I would say, hey, take a breath, because there are benefits which I'll talk about in a little bit, so flow-throughs. And you see down here, the lower -- the new tax rates on the left are the old rates, on the right are the new rates. And what you can see if you look at the bold areas, not only the rates go down, but the brackets also got expanded. So if you look at the bottom, the 39.6 rate is now 37%. And so that's a 2.9 percentage drop in rate, that's terrific. But then if you look at the bracket, the income brackets have also gotten higher. So that 2.9 -- sorry, that 2.6% is actually higher, and you have to think about it.

The other thing to think about here, and people to lose sight off, a lot of people are in the alternative minimum tax on an individual level. So they don't get the benefit of that state income tax deduction, that got eliminated. So it really doesn't matter so much to people in the AMP [ph] and they get the benefit of the lower tax rate. So the tax cut will result in a windfall for them, obviously encourage investment. If you're not in the AMP and you live in one of these states, well, then you may be in an adverse situation, but you have to look at it. That's gone.

So one of the other beneficial things is this pass-through deduction. It's basically a 20% deduction on what -- it's called QBI, qualified business income. There are some limitations within the calculation you have to run, but what it really means is you have K1 income that's from a qualified business, you're entitled to take 20% as a deduction right on your return. Simple example that's up there is you have the restaurant, it's $500,000 of QBI or I'll just simplify it as K1 income. It's got some wages of 1.5 million and qualified property of 3.0. You run through all that math, but the short story is, on the 500,000, 20% or in this case $100,000 would be deductible.

Things that would offset it would be wages of the business, but typically restaurant wages are significantly high as a percentage of sales and the real estate portion of it. But I'd say most restaurants are going to be falling into that 20% of the K1 income, that is significant. That all of a sudden makes 37% tax rate for flow-throughs versus the 21% for C corps, that closes that gap a lot more and a lot faster.

But other things to be aware of in this, not all industries qualified for it, restaurants do, but accountants, lawyers, celebrities, professionals don't qualify for that 20% deduction rate. So what that really means is, Cindy and I are in the wrong business, but to some reason, engineers and architects are absolutely able to qualify.

The other thing and this isn't clear, remember, I said the code has not been written yet, it's not 100% clear. But a lot of restaurant companies do licensing deals or management deals. It typically is, if it's with a celebrity chef or high-branded restaurant company, they don't own the restaurant, the hotel does, the real estate developer does, and it's basically a management deal. It's not clear if that type of income structured that way would qualify for this 20% QBI deduction. The code hasn't been written. The conservative approach is, no it won't, the more aggressive approach might say it is. And no one has the answer to that. We spent some time in the office kind of debating that, because we represent a lot of high-profile celebrity chefs and clients that have that situation. And so we have to look at it and maybe think about how you structure the deal better to take advantage of the QBI.

Cindy McLoughlin

And Gary, just one thing. I will -- sorry, Gary, just another point on the management company or the management side that you're saying is that also applies, if you think of many of these private equity and how they are structured, a lot of the fund structures have management companies set up in there, so that may be a structure or may be a setup that won't be -- because those would not generally benefit from this, because of the limitation, those management companies within a fund. So that may be something elsewhere to effect in another avenue where you'll see that effect on the PE side too. So just another thing similar to, like you said, in the license deals, how that will effect those entities.

Gary Levy {BIO 17914334 <GO>}

Yeah, I think that has to be brought into play. I'm not sure if the management fee piece that gets paid it would be eliminated by that. I think that's okay. At least, that's what I was led to believe, but haven't confirmed -- haven't read the code in so much detail to say the answer to that one.

International, let me just touch on this quickly. So people are aware of it. Again, it is pretty complicated. This slide has tons and tons of words on it. And I don't profess to be an international tax expert, people around me did really know the stuff and actually gave me this slide. But simply put, there's a couple of things in here. One is the repatriation of foreign income and cash back into the US at a much lower rate, it's 15.5% and a real benefit of that is you can pay that tax over eight years, right, so that's a really nice windfall for companies to bring that into the much lower tax rate and pay it over eight years. The actual first payment is due April 15 of this year and the calculation isn't that easy. So I'm sure a lot of companies are going to be struggling with that calculation, but it's certainly going to be a windfall.

The other one is that we've changed ROE, modified our tax systems to now be more in territorial systems, and that basically may provide foreign entities such as US entities with foreign operations, brought in subs [ph] to bring income back and to potentially avoid tax. And the last piece is, going forward, in similar situations, we're going to be at a much lower competitive tax rate depending on how we're -- where business is being done on the global stage. So the international changes to the code are significant part of this tax plan, and it's really to make the US more competitive in tax rate with what's going on in the world.

So that was the good news. Some of the bad news, and again, remember I said before, you got to think about how things -- how this tax cut plays out with all the pieces, don't just look at it at one section and say this is great, because you could get bitten from other side, if you're not. So the limitation on business losses, this is new. It used to be, if you had a business and then had a big loss and you were at risk for the money in that business, and active, even if passive possibly, but predominantly active, you can take that loss fully on your personal return and move on. And almost in some cases have the ability to wipe out taxes that you would owe for the entire year. Well, now they said -- the new rule says, we're going to limit the ability for you to take a loss on your personal return. If you're married, it's $500,000; if you're single, it's $250,000. That's a big change.

The example here is, say, you have a couple, married, their wages are 1.2 million, one spouse is a breadwinner, the other one runs a business that loses a lot of money, so there is an $800,000 flow-through on the loss. Under the old rules, they'd be paying tax on $400,000. Under the new rules, they can only use 500,000 and they'd be paying tax on $700,000, that's a big change. The other side of the coin on this is the $300,000 that's carried over to next year, you're limited to only using 80% of that. So you could have a situation where you lose the benefit of that $300,000. I'm sorry, I just realized that we skipped over a slide. Did we skip over? And I'm sorry to do this to everybody on the panel, did we skip over the depreciation slide? We did, didn't we?

Cindy McLoughlin

Yes.

Gary Levy {BIO 17914334 <GO>}

Yeah, we did. So let me just go back to them. Sorry I hit the wrong button. Good thing is, it's important to bring this up, because the new depreciation rules give 100% bonus to assets placed into serve in the restaurant, that will encourage investment, the opening of more stores. Even according to Mike, we have too many, that will encourage investment, absolutely a good thing to have. We have a situation where you have an existing restaurant, it's got $1 million in profit, will now use that money and go build the new store, you can get $1 million tax deduction to eliminate any tax effect that would have. That's terrific and very encouraged. And Section 179 that includes to $1 million from $500,000, all good things for the industry.

But you just have to be aware on bonus depreciation that the states typically do not recognize bonus. They decoupled from it. And what they make you do is add back the depreciation on the state returns as active income, and you could have a situation where you have passive investors who have now active income flowing through to them, because of bonus and passive loss from the ongoing from the business, and they could have an adverse situation where they own money to the states, and a loss they could not use. You need to be aware of that. Absolutely need to be aware of that. And then you can take Section 179, states recognize that, so then take 179.

But the thing to think about is, if you take bonus or 179 to that matter, that lowers your QBI, your qualified business income, and lowers that 20% deduction we just talked about. That might not mean anything, but it's something to think about, especially if you take bonus, you have that state add back as I talked about, and then you don't even get the benefit of the QBI on the federal level. A lot of moving parts, a lot of math that's got to be done to see what's in the best interest.

All right, so let me skip on. And as I said, these will sunset, and you can see in here that the rates go down over a period of time. So bonus will eventually go away unless the law changes. Sorry for skipping ahead what was important. We covered that, we talked about the limitation on business losses. Same situation, bonus depreciation here could generate significant losses that you may not be able to use, because once you get to that $0.5 million, you're stuck, and then 80% can only be used as loss going forward, adversely affecting the benefit of having bonus depreciation. Think about those things and the ramifications.

Next one, business interest expense limitation. This is also brand new, and the bottom line here is that, this will basically say, you are allowed to deduct interest up to 30% of what -- they it's a adjusted taxable income, ATI, it's really EBITDA for now, and 30% of what your EBITDA is. And eventually it goes after four years from now in 2021, it just goes to EBIT. So now depreciation is part of that component. But in the reality, as so many restaurants are financed with debt, people structure deals for the raises, there maybe a debt component. You do a private equity deal, they will leverage up the company if a debt is relatively re-accessible, it's inexpensive to get done. So they're going to use the debt to grow the company.

You could have situations, in the past, it would be like, great, interest is fully deductible, let me take that. That really helps. Now under this new limitation, the benefit of interest possibly will not be deductible depending upon the math, especially when it goes to EBIT, or even as you add stores and you grow. So those are things that you need to be aware of, and I think will dramatically change how private equity funds structure their deals and even potentially affect valuation, because they may not lever or put as much debt on these businesses as they could in the past. And obviously, that would affect the ability for them to do valuation.

And one thing to note is if your gross receipts are less than $25 million, you don't really need to worry about this. But if you -- that doesn't just -- if you have multiple restaurants under separate umbrellas you may have to combine all those sales, and that might get you over the $25 million hurdle, so that's something to be aware of. Again like I said, you move piece one way, and that's just another piece on the puzzle you need to be aware of it.

All right, so just other things you need to be aware of when you need to cover as you go into this that again affect the industry, (inaudible) employee meals are now only deductible for 50%, and in 2025 they will not be in deductible at all. Most restaurants will provide staff meal pre-service, free lunch, breakfast, and there will staff meal that's made available, that could add up, because there are still lot of people you're feeding over time. Well now, you can only deduct 50% of it, rather than deducting the full amount of it. Some restaurant companies, often the employees they bill it off the menu at discount that may be an offset to it, but -- and this could be a pretty significant add back or cost to a business, if they don't get a deduction.

New audit assessment rules, this is also I think going to change. Our people invest, do deals, I mean, invest in deals and kind of it really works like this. It used to be if -- there was an audit, the audit -- IRS came in and did an audit, when the audit was done, whatever years were affected, the people or partners in the business in those years would share the burden of that tax. Well, now, the business is required to pay the tax. I'm sorry this flow through into these. The business pays the tax. So, let's say, Mike and I are partners, he dies (inaudible) restaurant, I go away, two years from now he gets audited, and there's a huge assessment on the business, well, the business now has to pay for it. And that's from Mike and his new shareholders to deal with, and I get to walk away walk away scot free from it.

That's a big change in the rule, that will also require some change to some operating agreements about who is -- there's no longer a destination as a tax managed partner. I think what you'll see more and more is, especially in the transaction model PE funds, there if we are going do significantly more diligence or they going to ask for some type of indemnification for it. I just don't see how -- because they are going to want to cover for that. The repeal of the Domestic Production Activities Credit, it's known as DPAD, there's also as real ramification as to the business. That was basically if you had a commissary and I think you produce products for your restaurants, but you also sell to third-parties, you would have the ability to do a calculation to create a paper tax deduction, and it's pretty significant, and this is roughly about 10% of the company's taxable profit.

And we've had clients that added deduction which worth hundreds if not, in some cases millions of dollars depending on how things played out. That deduction has now gone away. That's an adverse effect of the industry and significantly will effect, I am sure, planning for people. Now the good thing is UNICAP rules. They've upped the floor on that. UNICAP is a calculation you have to do to capitalize some of the costs for storing your inventory, like which would include a percentage of your rent, some of your utilities, percentage of peoples and jobs that have stuff to do with the industry. That has also been up to $25 million, it used to be $10 million, that's good for smaller restaurant groups, larger restaurant companies, it doesn't matter.

And then lastly, the hold period for private equity funds investment, carried interest paid but now the hold period is now three years instead of it being one. I think what's important about that, and I was talking about PE fund that I do, we do a lot of work with it. He says, boy, that could put us in a conflicting position with some of our portfolio companies. But you can make an investment in a company, grow it, and 18 months from now the business has grown so great, and people may say, hey, I want to buy the company at a great valuation. Well, the founder might say, I want to do that, because, well, that's a lot of money, and I'll take my chips off the table at a capital gains rate.

The PE fund won't be in a capital gains rate position, and they may say, no, I don't want to do it, because that could adversely affect them from a tax position and they are limited. It's something to think about. I think it's something that's going to come on up in a bunch of deals and I think it will be debated and discussed. So, I tried to cover as quickly as I could the high points that affected the tax code. I will say, there's a lot here to speak to, your own individual advisers. We are actually doing programs locally that focus just on the tax code for the industry, and we even have done numerous webinars, and I'm sure there'll be more to come.

So, I think that's all I had -- I did. So, I am going to turn this over to Sarah to take it from here. Thank you.

Cindy McLoughlin

Yeah. Gary, just one quick thing before we move on from there. Just a quick question here. I know that in the past companies would have a change of control events of some sort and that would trigger certain technical termination, clauses in partnerships and then require changes in different returns that needed to get filed and various things. And I believe that that's gone away, correct?

Gary Levy {BIO 17914334 <GO>}

Are you talking about the technical termination? Yeah, the technical termination --

Cindy McLoughlin

Yeah, the technical termination, so --

Gary Levy {BIO 17914334 <GO>}

Yeah, that is going away, absolutely. Well, that's a good thing. I mean, that's more of an administrative thing. It's kind of (inaudible) do anyway, pardon my language. So that was good to get to move on from there.

Cindy McLoughlin

Right. Okay, good. All right, wonderful. So now that we have this tax reform in companies that strategically have done right or going to have all those excess money and cash and things to do things with here, I guess in order to invest properly and whether it's technology, they really need to be looking forward, looking at trends and where the consumer is really headed and what they are wanting. So, Sarah, why don't you give us some road map as to where we should be thinking?

Sarah Lockyer

Yeah, absolutely. Gary, that was a great breakdown, and Michael obviously a good macro view of the industry. It's funny, Michael, when you mentioned that the PR spend and investing back into the labor force, that's clearly what's happening, and I think what's gathering a lot of the headlines. But a lot of companies are already saying pretty clearly that, with these tax savings, we're putting it back into our business, McDonald's said 6 billion I believe into the US market to re-image its stores. Brinker as well is re-updating its commitment to re-imaging the stores. And well that can be a lot of like window dressing, a lot of that is also technology base, kitchen display systems, kiosks, automation, tablets for wait staff things like that. So tech is clearly where a lot of this hopeful windfall will be. I'm happy to take that if you want, but, yeah, you can advance that, that's great.

I hope everyone can see this, it's a little small. What Technomic -- I am at restaurant business by the way Sarah Lockyer and a partner company of ours is Technomic, a leading market research firm, I'm sure many of you are familiar with. And we do various studies often about where the consumer is at in relation to what they want from the restaurant industry from a technology standpoint. And I thought this was extremely interesting and timely. This was done mid-'17. So nothing has changed since then and we will be redoing this survey in the first quarter of this year.

But what I saw that was very interesting about this slide here is that consumers really do see technology as a value add to their restaurant experience. And in this ranking, you can see something as simple as free WiFi, it's still very important to them. So a lot of the forward thinking restaurateurs and chains are always thinking very fast about mobile payments and mobile ordering and what's next, and voice recognition, and things like that. But sometimes the basics really do help and making sure you have fast free WiFi is very important to the consumer.

What I find very interesting though is this notion of tracking your order, whether that's in-store or through delivery, or when you're picking it up. I think consumers particularly on the younger side are very interested in control and they want to see exactly where their order is, has it been accepted it, is it being made, when will it be ready, I'm pulling into the driveway and do I have someone outside ready for me to pick up my order. So tracking is extremely important as well. You can see there some paid numbers and some mobile ordering numbers, which I can get into a little bit more detail on the next slide.

Kitchen automation system is listed here. It seems pretty low from a consumer standpoint, but I have to be frank, I'm not so sure how many consumers would really know what that means to them. I think if this question was more getting my Fruitini on-time with the right ingredients, and everything I ordered that would probably be at the high end of this list, but nonetheless it is there. So I thought that this is really interesting kind of hit list of what restaurant chains and restaurant executives can be looking at to make sure that they are indeed offering some value to their customers in the way that they perceive to be the most valuable.

So how important is mobile ordering really? Well, mobile ordering, if you're a millennial, it's extremely important. You can put lot of colors. So it's time to digest it. But this is off of about 1,000 consumer surveys and this is a kind of standard Top 2 Box Survey, so very important or important, is mobile ordering option important when you actually decide to go to a restaurant. That's the key there, not just in general. I mean, you can see that the millennial age group pretty closely followed by Gen X, finds this very important.

Michael had mentioned, casual diners and how they're going back to their roots and making sure they hit on the nostalgia and get some of the boomers in there, maybe some of the older Gen Xs in there, but then what's next, how do they really relate to the millennial. And something like this could be very important. You see 60% of millennials, so that's 25 to 34 years at casual dining rate, mobile ordering options, important or very important. So casual diners have to get on board with that, because I think what that obviously speaks to is convenience and speed and being able to order ahead and being in the car perhaps with your young family and picking someone from soccer, getting on your phone, ordering a meal at Chili's and being able to go pick it up. So I think that the casual dining (inaudible) technology will be a huge way that they can ideally kind of get themselves out of the negativity that they've seen over the last couple of years.

When you get to mobile pay, you see that it's not exactly hitting everyone in the same way. So it's not as important as the ability to order on your phone. I do want to make a note for some data geeks, little bit like myself. You can see that this switched from a wonderful breakdown by age group to a breakdown by measurement. I don't know why that is. If you want to reach out to me and see if can get the matching slides I would be happy to do that. Technomic does fantastic work and a lot of it is based on customer reports for clients and things like that. So this could have been perhaps a request as opposed to a survey set apples-to-apples. So, that's my apologies. Nonetheless, I do think the trend line remains at payment on your mobile is important, of course, but it's not quite as strong as we're seeing in the 50s and 60s of important range when it comes to actually being able to order on your phone. And it looks like it's pretty standard across the board here in terms of the segment breakdown.

So royalty and rewards, I would definitely place under tech. I think if anyone is still using a punch card, it might be time to upgrade to something either via mobile or other. You can see that these do indeed matter. Millennials and Gen X in particular are looking for these loyalty rewards and they are using mobile platform to redeem. These whatever mobile they want, and they are looking at restaurants that have the right loyalty programs for them when they are deciding who to visit.

I think the millennial generation right now, most of us sometimes think about the teenagers. I think that's still in people's head that millennials are these teenagers on their phones, but they are not anymore, they are parents, they are younger families, they are dealing with the same economic stresses that many people are, if not more. And things like loyalty programs, any types of discounts, any couponing, anything that helps them find the right deal and the right value that then gets delivered to their phone, which is where they live. Is this really a good recipe for getting that customer through the door and ideally getting them to come back.

So we also -- so that's a lot of mobile, but I also want to talk a little bit about tabletop ordering, which again back to the casual dining point, what can casual diners do in particular to do some tabletop ordering options. Chili's has seen some pretty good results with their partnership with Ziosk. I know that the average check is extremely -- is much higher and I knew that it's something that they look forward to in terms of the data that you get on the customer and how that can be used on top of the customer dining experience. But this again here is the importance of how important you read [ph] providing of tabletop technology when deciding which restaurant to visit. And you can see a big whopping 42% millennial at the family restaurants and 43% Gen X access casual, which I thought was very interesting. But nonetheless, you see some pretty high numbers here.

Millennial and Gen X is well over indexing the entire overall percent number.

What's really interesting, I didn't add this here and I probably should have, I don't think this is pretty obvious I think for those of us who have families, but the Gen X and millennial use of tabletop ordering is mostly due to content for children. So if there is content for children on those tabletops, people are very happy and they go to that restaurants and they sit at that restaurant and most likely order another drink or order another dessert and that's where you get your check up and that's where you might lose a little on the time of the table, but you are getting that check, you are getting that customer to come back the door.

So these tabletop options for casual dining in particular are indeed important. It isn't a novelty. I think years and years ago when they were first starting to roll out everyone was kind of like, they are just doing it to cut labor and maybe that's part of it, but it really has become something to customer actually enjoys that isn't just about the P&L and the labor line.

I went kind of quick, but I also wanted to do a real quick look at -- the theme here was kind of Restaurants 2020. This might not be two years out, this might be a little bit more, but there are some four buckets that restaurants, chains to small should really be looking at and some are really looking at when it comes to where to invest in technology. Voice recognition software obviously is something that the whole world is a little bit obsessed with right now with Alexa and everything else. And that will be important.

People do want to order Domino's from Alexa, they just do. They want to be able to order their Starbucks order from their car. This stuff will happen. But what I see actually as some of the bigger benefits to the restaurant business itself is back of house voice recognition potential. So operations, I believe has the largest potential here for general managers to be able to control their inventory, to be able to get very smart, very real time alert to be able to order, what they need quickly via voice that really drives efficiency. It can lower labor costs, it will make your general managers much happier people, which could help with retention. But the day of saying, Alexa, I need another case of vinaigrette actually will happen. And I think it will happen soon and I think it's something that businesses should really be making sure they're staying at least aware of.

Progressive web apps are something that doesn't get a lot of sexy media attention, but Panera or Dunkin' or Starbucks, you're really not going to get space on your customer's phone. I don't know how many restaurants look at their funds right now and see how may restaurant acts we have, but it's probably not that many.

Gary Levy {BIO 17914334 <GO>}

In research, there is about -- people average about three.

Sarah Lockyer

There you go. I mean, there is just no space any more, and that's not how people want to really interact with their phone and with the brands they like. Nonetheless, you want the option to order ahead to get coupons to be marketed to get deals. And so a web app is not an actual app you have to download, basically it is a mobile site, basically a website that's mobile friendly, they call it progressive, because it works on any browser, any tablet, any phone. The experience is very seamless for the customer, for the consumer, for the user. But it does allow less money in terms of app development and it is something that I believe consumers will start doing more and more. I believe Apple also just released some code type release that's way above my level. But that makes the building of these progressive web apps and the usage of them offline a reality very soon. So I think that will be something that a lot of restaurant chains, at least some are starting to look at.

Facial recognition, isn't just the new iPhone, and it isn't just Amazon Go which just opened, but you know CaliBurger, it is using facial recognition software at their kiosks. It's not for payment yet, but it's to connect your loyalty program, and it's to connect to any formal orders you had. So again, that's something that when you are looking out to 2020 and beyond to be aware of. And then I think something that we could spend a whole webinar on it, it would definitely not be me, it will be all of great digital players like OLA or HotSchedules, or others. But Big Data is finally moving into kind of that real data time world, where it's not just overwhelming data anymore that no one really knows how to use. The tech companies have become very smart, they're partnering with each other, they are layering their services on top of each other and making it really easy for restaurants to offer the things that consumer wants, and making it easy for the actual business to start understanding their own customer's needs.

So there is not a lot of excuses anymore to not be playing in that space since you are not using the data to your benefit as a business.

So it's a quick overview on kind of where tech is headed. I do think that one thing, and I forget if it was Starbucks or Panera, but technology as a lifestyle or technology as a way to drive convenience is the way that winning businesses and winning restaurant businesses really look at technology. It's less about what app you have or do you offer this or do you provide x, y and z. It's really about understanding what your customers want. Not every customer is going to want everything under the sun. So make sure you know who your customer is, who is your bread and butter is and start delivering the technology that they want.

Technomic did a survey last year where 81% of the people surveyed, I think it was about a 1,000 consumers, restaurant goers need food service on a daily basis, breakfast, lunch, dinner or whatever. And that 43% of them said, tech is really important to make that food service convenient. So that's a big number, and it is an important part of our restaurants business. I don't think anyone is denying that. But I think it's time, especially if these cost savings really are happening or these tax savings are happening to dive in. I will note that I didn't talk about delivery at all because I honestly don't consider that really tech. I consider that, you got to figure that operationally and then get up their party. So happy to talk delivery if all is needed, but I wanted to kind of get into some of the other nitty-gritty more tech investments, but hope that was helpful.

Cindy McLoughlin

Yeah. No, I think this was really great. And I think if anybody has any questions, if they want to send that in, I know we have a couple here on the docket. Let me go ahead and check that. There is some question specifically, and I think we covered this, Gary, just how the new rules on 179 impact specifically new construction if at all. I think we kind of covered that. I didn't know if you wanted to highlight anything specific on that. Yeah. No, I didn't know. And then we have one just about on kiosks making a difference.

Sarah Lockyer

Gary, let me grab one question real quick. So there is a question about kiosks making a difference for chains. If you want to shoot me a note, I can get used to (Technical Difficulty) data. And Michael, you might have some chain specific reference. I know what's happening is, I believe McDonnell has been really happy with the performance of its kiosks, which is why they are accelerating the re-imaging and the use of the kiosks across the country. I don't have much more color on that. Wendy's, when I spoke to them, but this is over a year ago, kind of like, some people don't know how to use it. I believe they are making a huge difference. I don't have anything like actual data behind this.

Michael Halen {BIO 18797919 <GO>}

Yeah. In our world, in the public chain world, the companies that have them installed or in the process of installing them like McDonald's are seeing a significant bump. Management teams are talking to the significant sales bump that they're getting in QSR. On casual dining, we're not seeing a bump. That's come and gone. So a few years ago Brinker got a boost for about a year, probably helped them by about 200 basis points. But since then, it's almost like a cost of doing business for some of these casual dining chains or the truck families.

Cindy McLoughlin

Okay. And I guess shifting just on the chains of like fast casual, do you see any sort of difference on their --

Sarah Lockyer

I found that data point still interesting, that people are interested in looking at automation in fast casual, because I guess that some of the examples are maybe Wow Bao, Chicago, honeygrow. I don't have the details on the performance of that. So I apologize for that, but I feel like it is really new. I think the only one's we're hearing from are the big public QSR chains.

Cindy McLoughlin

All right.

Michael Halen {BIO 18797919 <GO>}

Yeah. We will make these slides available -- usually about 24 hours after the end of the webinar a replay is available on the same website that you used to sign up, and then we'll also send out the slide deck and the link to everyone who signed up and listened in.

Cindy McLoughlin

All right, wonderful. Well, thank you everybody for joining us. And like I said, you have everybody's contact information if you have specific questions, and we'll be happy to help you. Thank you.

Gary Levy {BIO 17914334 <GO>}

Thanks, guys.